The Policy of Foreign Takeovers in Canada's Non-Renewable Resource Sector

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ABSTRACT

The purpose of this thesis is to provide an overview and assessment of the policy and process related to foreign investments, and particularly either a partial or complete acquisition of companies operating in the natural resources sectors in Canada. More specifically, the purpose is to ascertain problematic features of that policy and process, and to identify and recommend some potential reforms for eliminating or at least minimizing those problems. For that purpose, this thesis provides an overview and analysis of two recent and precedent-setting takeover bids in the non-renewable resource sector that were reviewed by Prime Minister Stephen Harper's Conservative government, namely the BHP Billiton 'hostile' takeover bid for Potash Corporation of Saskatchewan (PCS) in 2010, and the China National Offshore Oil Company (CNOOC) 'non- hostile' takeover bid of Nexen Inc. in 2012.

The four central research questions are: Why did the federal government not approve the BHP Billiton takeover bid of PCS? Why did the federal government approve the CNOOC takeover bid of Nexen? What do these two decisions by the federal government suggest are the problems in the foreign investment review policy and process? What reforms are needed to the foreign investment review to eliminate or at least reduce some of those problems?

The answers provided by this thesis to those questions are as follows. First, the federal government did not approve the BHP Billiton takeover bid of PCS because it was a 'hostile' bid strongly opposed publicly both by PCS and by the Saskatchewan provincial government. Second, it approved the CNOOC takeover bid of Nexen because it was a non-hostile bid and was not opposed either publicly or privately by Nexen or any provincial government. Third, both decisions by the federal government suggest that there are some significant problems with the foreign investment review policy and process. Fourth, several reforms are required to eliminate or reduce some of the significant problems with Canada's foreign investment review policy and process that became evident in the context of the two reviews undertaken and decisions rendered by the federal Conservative government led by Prime Minister Stephen Harper.

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CHAPTER 1: INTRODUCTION

1.1 <u>Purpose & Objectives of Thesis</u>

The purpose of this thesis is to provide an overview and assessment of the policy and process related to foreign investments, and particularly either a partial or complete acquisition of companies operating in the non-renewable resource sectors in Canada. More specifically, the purpose is to ascertain problematic features of that policy and process, and to identify and recommend some potential reforms for eliminating or at least minimizing those problems. For that purpose, this thesis provides an overview and analysis of two recent and precedent-setting takeover bids in the non-renewable resource sector that were reviewed by Prime Minister Stephen Harper's Conservative government, namely the BHP Billiton 'hostile' takeover bid for Potash Corporation of Saskatchewan (PCS) in 2010, and the China National Offshore Oil Company (CNOOC) 'non-hostile' takeover bid of Nexen Inc. in 2012.

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Stephen Harper.

In analyzing Canada's Foreign Direct Investment (FDI) policy and process, the principal focus of this thesis is on the six factors contained in the *Investment Canada Act (ICA)* that are used by the federal government to evaluate foreign takeovers above a certain monetary threshold, otherwise known as the "Net-Benefit Analysis." The "Net-Benefit Analysis" is the foundation of the entire foreign takeover review process as defined in the Investment Canada Act (ICA). A private sector investor from a country that is a member of the WTO pursuing a takeover of an enterprise valued at greater than $600 million (as of March 2017) must demonstrate to the minister responsible for the ICA that the proposed takeover satisfies the six factors outlined in the ICA in order for the takeover to be approved. These factors are extremely broad and focus entirely on basic economic concerns. "In determining whether an investment is of "net benefit", the Minister will consider the following factors:

1) The effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada.
2) The degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part.
3) The effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada.
4) The effect of the investment on competition within any industry or industries in Canada.
5) The compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment.
6) The contribution of the investment to Canada's ability to compete in world markets." (Government of Canada, 2013)

The Minister responsible for the Investment Canada Act must balance these six factors when evaluating a foreign takeover that meets the minimum financial threshold for review. The current policy is that these factors are all of equal importance and that none is more important than any other. These factors are exceptionally vague, and the Minister is not required to disclose why a takeover decision was blocked or approved, rendering these factors essentially meaningless. Since there is no transparency, the Minister can make a decision for any reason at all, including an entirely political or partisan objective. This is a common criticism of the ICA and the "net benefit" test contained therein that has not changed substantially since Canada began formally reviewing foreign investment in the 1970s.

It is important to recognize that all of the factors contained in the current "net benefit" test are economic or monetary-focused, which is completely in-line with the purpose of the Investment Canada Act. However, in order for Canadians to fully *maximize the benefit* associated with foreign direct investment, it is worthwhile for policy-makers to consider additional factors. To completely ignore environmental factors, the impact on Aboriginal peoples, an investor's commitment to corporate social responsibility, or an investor's human rights record abroad is an approach that fails to appreciate the leverage this Act allows in the promotion of Canadian values and interests.

As opposed to a "net benefit" test that only considers economic factors, a new "maximum benefit" test would evaluate a foreign takeover based on a triple-bottom-line analysis. A triple-bottom-line analysis (economic, environment and social) would ensure Canadians derive *"maximum benefit"* from the acquisition of any "Canadian" non-renewable resource corporation. A "maximum benefit" test represents a logical progression from what began as a "significant benefit" test in the 1970s and became a "net benefit" test in the 1980s. The primary objective of a "maximum benefit" test would be to *maximize the public benefit* in any foreign acquisition of a "Canadian business." In addition to a triple bottom line analysis, this test would consider additional factors that directly impact the *Canadian public*, including national security and the impact of any acquisition on provincial royalty revenues, therefore requiring a mechanism or policy that enables greater federal-provincial collaboration.

1.2 <u>Choice of Case Studies</u>

For that purpose, this thesis provides an overview and analysis of two recent and precedent-setting takeover bids in the non-renewable resource sector, namely the BHP Billiton 'hostile' takeover bid for Potash Corporation of Saskatchewan (PCS) in 2010, and the China National Offshore Oil Company (CNOOC) 'friendly' takeover bid of Nexen Inc. in 2012. The decision to focus on those two particular case studies is based on several considerations. First, these are the two most recent major case studies of foreign takeovers in

Canada. Second, both companies that were the target of the takeover bids were involved in the extraction of natural resources, even though they were involved in the extraction of different types of natural resources (i.e., potash versus oil and gas). Third, although they occurred two years apart both were undertaken by the Conservative federal government, which was led by Prime Minister Stephen Harper. Whereas the first decision was made while the Conservatives had a minority government, the second decision was made while the Conservatives had a majority government. Fourth, these are the two largest proposed foreign takeovers of resource corporations in Canadian history to date; whereas the 'unsuccessful' BHP Billiton (BHPB) hostile takeover attempt of Potash Corporation of Saskatchewan (PCS) in 2010 was worth $38.6 billion, the 'successful' CNOOC takeover of Nexen Inc. in 2012 was worth $15.1 billion.

Fifth, both decisions on these two proposed takeovers are historically significant in another way. The BHP Billiton attempted takeover of PCS is historically significant because it would have represented the largest foreign takeover in Canadian history. Furthermore, the decision to block the sale of PCS in 2010 set a new precedent for Industry Canada, which had until then approved all but one out of more than 1,600 takeovers of Canadian firms since the Investment Canada Act came into effect in 1985. The CNOOC takeover of Nexen is historically significant not only because it is the largest foreign takeover ever proposed by a Chinese state-owned enterprise in the world (Hutchinson, 2012) —a concerning trend for some, an opportunity for others— but also because it represents the first time that Canada imposed restrictions on future acquisitions by a state owned enterprise in the energy sector, effectively declaring oil a *strategic resource* and therefore *off-limits* to future foreign state-ownership—despite state-owned enterprises (SOEs) owning 75% of global reserves, representing the largest potential global source of foreign direct investment in the energy sector (Bremmer, 2010).

Sixth, whereas the hostile BHP Billiton takeover of PCS was denied by the federal government with the encouragement and support of PCS and the Saskatchewan provincial government, the CNOOC non-hostile takeover bid of Nexen was approved by the federal government without any publicly visible opposition either by the company that was the target of the takeover (i.e., Nexen) or by any provincial government. Notably, Premier Alison Redford did not oppose the CNOOC takeover bid based on the fact that a private company would be taken over by a state-owned enterprise, in this case one owned by the People's Republic of China. This is in sharp contrast to Premier Brad Wall's public opposition to PCS being acquired by an Australian-headquartered private enterprise (i.e., BHP Billiton). This occurred despite the fact that Australia is a Commonwealth ally.

Seventh, both PCS and Nexen evolved from Saskatchewan-based Crown corporations. PCS originated in 1975 as a Crown corporation of the province of Saskatchewan until it was fully privatized in 1990. That same year, Canadian Occidental Petroleum (CanOxy Ltd, later Nexen Inc.) acquired Wascana Energy Inc., formerly Saskatchewan Oil & Gas Corporation (SaskOil)-a former Crown Corporation of the province of Saskatchewan. Prime Minister Harper acknowledged this trend, when announcing the acquisition of Nexen by CNOOC, a Chinese state-owned enterprise, stating, "To be blunt, Canadians have not spent years reducing the ownership of sectors of the economy by our own governments, only to see them bought and controlled by foreign governments instead" (Whittington, 2012). And yet, by approving the takeover, his government enabled exactly that to occur.

It is not a coincidence that, once privatized, these and other former Canadian Crown corporations would be targeted and acquired by foreign individuals and entities. Such is the risk of privatizing non-renewable resource companies in an increasingly globalized economic era. As a result of privatization in a globalized era, these and other former Crowns (e.g., PCS, SaskOil, Petro-Canada) have gone from Canadian-owned entities to mere "Canadian businesses", meaning they have a place of business in Canada, have employees and physical assets in Canada, but are no longer majority Canadian-owned. The reason for this occurrence is that in publicly traded private companies, nearly anyone, anywhere in the world, can buy a share. And yet, whether or not a Canadian business is majority-owned by Canadian interests, its "acquisition of control" by a non-Canadian will trigger a review under the ICA if the value of the investment is above the applicable threshold, and as long as it meets the broad definition of a "Canadian business" under the Act. Thus, when BHP Billiton made its hostile takeover attempt for PCS, the latter was only 49% Canadian-owned (Coyne, 2012). And when CNOOC Ltd. acquired Nexen Inc., the latter was approximately 70% foreign-owned (De Souza, 2012).

Eighth, and closely related to the seventh reason for focusing on these two cases of corporate takeovers in the non-renewable resource sector, is that both of the companies targeted for takeovers were ‘Canadian-headquartered’ but not ‘Canadian-owned’ or ‘Canadian controlled’ companies. So, in neither of these takeover cases was a Canadian-owned company being acquired. This would likely come as a shock to the majority of Canadians who believe the foreign acquisition of a “Canadian business” means a Canadian-owned company is being lost, which is not the case. Rather, in both these case studies, a *Canadian-headquartered* company was being acquired, and in the case of PCS, many would challenge the assertion that its headquarters were in fact in Canada. Prime Minister Stephen Harper acknowledged this fact when he stated, in the House of Commons, that the takeover attempt by BHP Billiton for PCS was a "proposal for an American-controlled company to be taken over by an Australian-controlled company" (Toronto Star, 2012). This statement was widely regarded as a signal that the federal government was going to approve this particular takeover bid as had been the standard in Canada, until Saskatchewan’s Premier Brad Wall launched an effective and unprecedented campaign to block the hostile takeover bid.

1.3 <u>Central Research Questions Of Thesis</u>

To reiterate, the purpose of this thesis is to provide an overview and analysis of Canada’s foreign investment review policy and process based on those two case studies, with special attention devoted to the problematic features and some of the means by which both the policy and the process can be improved. In keeping with that purpose, the four central research questions are:

- Why did the Conservative minority federal government not approve the BHP Billiton takeover bid of PCS?
- Why did the Conservative majority federal government approve the CNOOC takeover bid of Nexen?
- What do these two decisions by the federal government suggest are the problems in the foreign investment review policy and process?
- What reforms are needed to the foreign investment review to eliminate or at least reduce some of those problems?

1.4 <u>Theoretical Perspective of Thesis</u>

In explaining the factors that affected the governmental decisions to approve one of these proposed takeovers but not the other, this thesis employs a state-centric perspective. The decision to do so is based on the argument that made by a leading political science professor that: “Federal and provincial governments are not neutral containers, or reflecting mirrors, but aggressive actors steadily extending their tentacles of control, regulation, and manipulation into society... "(Cairns, 1977). The analytical focus of this thesis is therefore on the interests and imperatives of the federal and provincial governments as well as their respective constitutional and political authority within the Canadian federation. In emphasizing this point Cairns stated that "…federalism, at least in the Canadian case, is a function not of societies but of the constitution, and more importantly of the governments that work the constitution" (Cairns, 1977). This perspective recognizes that the federal and provincial governments generally operate within the parameters of the constitution and pursue objectives that are most conducive to their respective policy and political interests not only as governments responsible for ensuring the legitimacy, development, and sustainability of their respective components of the Canadian state, but also as partisan political entities within the political system. With this in mind, the state-centric approach suggests that careful attention should be devoted to the policy and political interests/imperatives of the federal and provincial governments and the national and international political and economic contexts in which they are making those policy decisions. In short, careful attention must be devoted to the technical rationality, and the political rationality that shapes their respective decisions. Invariably decisions are shaped by complex calculations conducted by each government at any particular point in time based on a mix of policy rationality, political rationality, and bureaucratic rationality (Miljan, 2008; Conn et al., 1973).

In making decisions of mutual importance the federal and provincial governments engage in what is known as executive federalism and what has been dubbed as "federal-provincial diplomacy" (Simeon, 1972). As Simeon points out: "In Canada…the [intergovernmental] interaction takes many forms, but one process stands out as a distinctive characteristic of the Canadian federal system and has played a vital role in the development of many national policies. This is the process of direct negotiations between the executives of different governments…."(Simeon, 1972:7). Finally, it is important to note that in employing a state-centric perspective, this thesis also recognizes that governments make decisions in the context of the complex and dynamic national and international environment and particularly the political economies of those environments, rather than in a vacuum. As Simeon pointed out in his seminal work in rejecting either purely sociological or legal/institutional factors in explaining governmental policy-making processes or policy decisions. "More likely there is a subtle interplay between three broad sets of factors: (a) broad social and cultural characteristics, (b) institutional and constitutional factors, and (c) the particular attitudes, goals, demands and problems facing the system at a given time” (Simeon, 1972:8).

Although this thesis has privileged the 'state-centric perspective' and ‘federal-provincial diplomacy’ as conceptual lens through which to analyze the decision-making processes and the decisions related to the two case studies of foreign investment decisions, an important caveat is in order. The ability to get the information needed for analytical purposes was compromised by the secrecy surrounding federal-provincial diplomacy and the inability to get some of the principal actors to share more information regarding the full extent to which federal-provincial intergovernmental negotiations were undertaken, the key agenda items, the precise positions of the various governmental actors, and the influence exercised up any of them by private sector actors. As is explained below, much of this thesis was written by relying on information that was readily available in publicly accessible sources.

1.5 Contribution of Thesis

This thesis makes an important contribution both at the academic and applied levels. At the academic level it contributes to filling a research void. Although there is substantial academic and think-tank based research on Foreign Direct Investment (FDI) in Canada and the Investment Canada Act (ICA) from an economic perspective, there is little research on any aspects of the two largest attempted takeovers of resource corporations in Canadian history (BHP Billiton attempted takeover of PCS and the CNOOC Ltd. takeover of Nexen Inc.). An analysis of these takeovers within the historical context of Canadian public policy is valuable because it supplements the existing literature that is already available on Canadian foreign direct investment and corporate takeovers. This literature includes but is not limited to Assaf, and McGillis’ *Foreign direct investment and the national interest*; the Conference Board of Canada’s 2012 report *Current rules impede Chinese investment in Canadian resource sector*; the Conference Board of Canada’s 2010 report *Saskatchewan in the Spotlight: Acquisition of Potash Corporation of Saskatchewan Inc.— Risks and Opportunities;* University of Toronto Business Professor Wendy Dobson’s 2014 study *‘China’s State-Owned Enterprises and Canada’s FDI*; Globerman’s 2015 Fraser Institute study *An Economic Assessment of the Investment Canada Act;* and O’Sullivan’s 1980 *‘Canada’s Foreign Investment Review Act Revisited’*.

At a practical level, this thesis contributes to what is otherwise a scarcity of research and knowledge on lessons that have been, or can be, gleaned from these two takeover initiatives and the reforms that may be required to existing policies on foreign takeovers in the non-renewable resource sector. This lack of attention to what policy lessons can be gleaned from these two case studies is surprising given the importance of properly managing Canada's resource-rich economy through appropriate policies. The economic impact of non-renewable resources on Canadians is profound, making the regulation of foreign takeovers that directly impact these industries of paramount importance to Canadians.

1.6 Research Methodology and Information Sources

This thesis employs a critical case studies approach in providing an overview and analysis of Canada's foreign investment policies by analyzing two recent and precedent-setting takeover bids in the non-renewable resource sector (the BHP Billiton hostile takeover bid for PCS in 2010, and the CNOOC Ltd. takeover bid of Nexen Inc. in 2012), this thesis employs a critical case study approach. The central feature of this approach is that the case studies are examined in detail for the purpose of identifying policy problems and potential solutions to those problems.

The information needed to provide the overview and analysis of the two case studies was derived largely from the extensive body of primary and secondary sources such as government documents, government-initiated studies, ministerial statements, speeches, books, journal articles, and newspaper articles most of which were accessed online.

1.7 Organization of Thesis

In addition to this introductory chapter, which has outlined the focus, objectives, research questions, research methodology and information sources, the remainder of this thesis consists of four other chapters:

- Chapter 2 provides an overview of the existing policies, processes, and challenges regarding foreign direct investments and foreign corporate takeovers in Canada's non-renewable resource sector.
- Chapter 3 provides an overview and assessment of the policies and politics related to the federal government's decision not to approve the proposed hostile takeover bid by BHP Billiton of PCS.
- Chapter 4 provides an overview and assessment of the policies and politics related to the federal government's decision to approve the takeover bid by CNOOC of Nexen.

- Chapter 5, the concluding chapter, serves a dual purpose. First it provides a summary overview of the answers to the four research questions addressed by this thesis regarding investments and corporate takeovers in Canada involving foreign owned or controlled companies. Second, it provides some directions for further study of the issues that arise in the two case studies that are the focus of this thesis.

CHAPTER 2:
FDI AND FOREIGN TAKEOVERS IN CANADA'S NATURAL RESOURCE SECTOR

2.1 Introduction

The objective of this chapter is to provide a summary of the significant policy issues and challenges associated with foreign direct investment and foreign takeovers in the Canadian non-renewable resource sector. In order to understand the specific issues that arose during the two takeover cases studied in this thesis, a contextual and historical understanding of Canadian policies related to FDI and foreign takeovers in Canada is required. This chapter will discuss the history of Canadian FDI policy, the global economic factors that have shaped these policies, the value and importance of FDI in Canada's resource sector, and the impact of federalism and partisan politics on Canadian FDI policy. This chapter will also introduce and discuss the main policy flaws in Canada's current foreign investment review process. These include the need for the environment and Aboriginal people and their communities to be considerations in Canada's foreign investment review process; and the lack of transparency and accountability that currently plagues Canada's foreign investment review process. This chapter consists of several subsections devoted, in turn, to an analysis of each of these topics.

2.2 The Importance of the Non-Renewable Resource Sector & The Need for Regulation

The regulation of foreign takeovers in Canada, and particularly foreign takeovers involving non-renewable resource corporations of provincial, national, and international importance, has long been one of the most contentious policy challenges for a country and a people so heavily dependent on non-renewable resources for their livelihoods. "There are long-held concerns in Canada that foreign capital, left unchecked, would purchase and control many of the country's most valuable assets. This, it is argued, would result in a "hollowing out" of Canadian industry and leave a branch plant economy, with management jobs and profits repatriated to foreign corporate headquarters and with Canada's most talented and ambitious labour in hot pursuit" (Assaf and McGillis, 2013).

When the foreign acquisition at issue involves potash in Saskatchewan, or oil in Alberta, as was the case in the unsuccessful BHP Billiton hostile takeover attempt of PCS in 2010, and the successful CNOOC Ltd. acquisition of Nexen Inc., controversy runs very high indeed. Saskatchewan is the largest jurisdictional potash producer in the world, accounting for 25 to 30 per cent of the world's potash production and over 50 per cent of the world's potash reserves

(Wall, 2010). Alberta's oil sands reserves are the third largest in the world, and as of 2014 oil royalties accounted for $5.2 billion or 55 per cent of Alberta’s $9.6 billion annual non-renewable resource revenue (Alberta, 2014). Non-Renewable resource revenues have often averaged 20% of Alberta’s total revenue. However, in the last two years, oil royalties have decreased nearly 90% or $8.5 billion as a result of lower global commodity prices, plunging the economy into a recession. The severe decrease in non-renewable resource revenue in Alberta has been by far the largest contributing factor to a predicted deficit of $11 billion deficit in 2017/18 (Wood, 2016).

The impact of the non-renewable resource industry on the Canadian economy is profound, making the regulation of foreign takeovers that directly impact this industry of paramount importance. In 2008-09, Saskatchewan received $2.5 billion in royalties from oil, and $1.3 billion from potash and non-renewable resource revenue accounted for 20.4% of Saskatchewan’s total revenue (Saskatchewan, 2008). In 2009-10, non-renewable resource revenue accounted for 31.6% of Saskatchewan’s total revenue, primarily as a result of higher commodity prices, demonstrating both the dependence of the provincial government on this source of revenue but also its volatility (Saskatchewan, 2009). These two resources (potash and oil) provide billions in annual government revenue, employ hundreds of thousands of Canadians, enable the provision of necessary government services, and account for 20% of Canada’s nominal GDP, second only to the manufacturing sector. The Conference Board of Canada forecasts that “…the oil sands sector would generate $79.4-billion in federal and provincial revenues from 2012 to 2035” (McCarthy, 2014).

According to the World Bank, “Foreign direct investment is the net inflow of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor” (World Bank, 2017). Foreign direct investment (FDI) is a major contributor to growth in the non-renewable resource sector. “Access to international markets and foreign capital has given western Canada the financing — $116 billion between 2000 and 2010 — to develop its capital-intensive oil sands resources” (Assaf and McGillis, 2013).

2.3 <u>The Need for FDI in the Non-Renewable Natural Resource Sector</u>

The capital provided by FDI enables the non-renewable resource sector to grow, remain efficient, and to keep pace with demand. "If Canadian business were to rely on seeking capital only within Canada, the laws of supply and demand would dictate that our cost of capital would be much higher than the cost for our global competitors, which have access to greater capital resources. This approach would hinder the growth and competitiveness of Canadian businesses and the economy and their potential to create jobs..." (Assaf and McGillis, 2013). Without ongoing capital investment, the industry suffers. "Capital investment in the oil sands has decreased 62% in the last two years, causing layoffs and reduced revenues" (CAPP, 2016b). Furthermore, as a result of reduced capital investment "…it is estimated that 43,000 Albertans have lost their jobs since 2014 (CAPP, 2016b). Canada's non-renewable resource sector will require significant capital investment if employment figures and government revenues should rebound. Canada will also have to diversify its sources of FDI and remain welcoming of alternative sources as the U.S. share of FDI in Canada declines. Therefore, Canadian policy-makers must create a foreign investment process and regime that attracts the foreign capital associated with FDI, particularly from emerging and non-traditional markets.

FDI has numerous and substantial economic benefits. It can increase productivity, "…by providing access to new technology, business and manufacturing processes, and management know-how, as well as by fostering a competitive and innovative business environment" (Conference Board of Canada, n.d.). Inward FDI is also beneficial to the Canadian economy because it "…increases the pool, and competitively decreases the cost, of capital available to Canadian business to develop Canadian resources and create employment and training opportunities. It attracts top management talent to Canada and disseminates management training and expertise into the Canadian labour force. It facilitates technology transfer into the Canadian economy from foreign jurisdictions. And it further integrates Canada into international markets with concomitant reciprocal trade and investment accessibility for Canadian businesses" (Assaf and McGillis, 2013). Therefore, the policies that regulate and govern such a valuable form of investment in Canada must be constantly examined and updated, in this case, to reflect the realities and challenges of the present global economic era. Additionally, there are unique challenges associated with FDI and foreign takeovers in the Canadian non-renewable sector that require careful consideration by policy-makers.

2.4 <u>Factors that have shaped Foreign Direct Investment Policy</u>

2.4.1 <u>Canada's Policy Legacy on FDI & Foreign Takeovers</u>

The Foreign Investment Review Act (FIRA), implemented in 1973 by the Pierre Trudeau government initially governed the process for the evaluation of foreign takeovers in Canada. Since 1985, however, Canada's foreign investment review process has been governed by the *Investment Canada Act* (ICA), enacted by the Mulroney government in an attempt to attract more FDI. "For almost 40 years, the Government of Canada has reviewed possible takeovers of Canadian firms by non-Canadians. The reviews have occurred under different legislation, and different governments might see the balance between the benefits and costs of foreign investment differently" (Library of Parliament, 2014).

The FIRA was the first attempt by the federal government to regulate FDI in Canada. The implementation of FIRA in 1973 was the result of growing nationalist sentiments amongst the public in the early 1970's, "…from which developed a resentment of the seeming omnipresence of foreign business in the Canadian economy and a fear of the long-term consequences of such presence" (O'Sullivan, 1980). In particular, Canadian policy-makers were concerned about the economic influence and control of their neighbor to the South, the United States of America.

The FIRA stipulated that no reviewable investment would be approved unless the prospective investor could demonstrate that their investment is likely to be of "significant benefit" to Canada. This differentiates the legislation from its successor, the ICA, which required the investor to demonstrate a "net-benefit." The 'Net-Benefit to Canada Test' signaled that the government would not be as demanding in assessing foreign investment proposals as had been the case under FIRA's 'Significant Benefit to Canada Test'. Therefore, at the time of its implementation, the ICA was widely regarded as less-protectionist than the FIRA.

The purpose of the contemporary ICA is "to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada and to provide for the review of investments in Canada by non-Canadians that could be injurious to national security" (Government of Canada, 2013). "The passage of the ICA, was meant to signal a change in the government's attitude toward Inward Foreign Direct Investment (IFDI)—from concern about relinquishing domestic ownership of assets to foreigners, to enthusiasm about encouraging IFDI that promised economic benefits for Canada" (Globerman, 2015).

Several flaws were evident in the FIRA process and these same flaws remain in the contemporary ICA evaluation process. “The FIRA sets forth several factors which can be considered in determining whether a proposal will produce significant benefit. These factors are not always given the same weight, nor must all factors be considered in every investment review. In fact, the test of significant benefit is so vague that decisions may be made on almost any basis whatsoever including a political basis.” (O’Sullivan, 1980). Nearly 40 years later, these same criticisms are made of the ICA in large part due to the lack of transparency and accountability enforced by the Act. For example, the FIRA’s “significant benefit” and the ICA’s “net-benefit” test are nearly identical, and the fact that no one factor is given priority over any other has not changed. Furthermore, both Acts afford the Minister responsible, or Cabinet, a significant amount of discretion in approving or denying the investment without having to disclose any reasons publicly, allowing decisions to be made on a political basis.

Although widely regarded as a protectionist policy “…it can be said with certainty that the FIRA has not discouraged businesses from investment in Canada. While passage of the Act may have intimidated many investors initially, economic indicators show that Canada remains an attractive market” (O’Sullivan, 1980). In fact, under FIRA “…the number of investment proposals submitted to the Review Agency has increased every year, from 230 in 1974-75 to 454 in 1976-77 to 818 in 1978-79” (O’Sullivan, 1980).

Although the FIRA rarely blocked any foreign takeovers, and was heavily criticized by Canadian protectionists/nationalists for that reason, the Progressive Conservative (PC) government still replaced the previous Liberal Government’s FIRA with the ICA in 1985 in an attempt to create a more welcoming environment for foreign investment. The ICA, in contrast, would enable federal civil servants to actively seek out and encourage foreign investment, not just review it, and the requirements for review were softened. And yet, Canada’s share of foreign direct investment has dropped since the implementation of the Investment Canada Act (ICA). “Previous Conference Board of Canada research showed that the Canadian share of global FDI flows dropped from 16 per cent in 1970 to 3 per cent in 2009” (2012a). However, this is likely a representation of a more diversified global economy. India and China’s share of global FDI has increased significantly in the same period.

Therefore, neither the FIRA nor the current ICA has been an excessive barrier to FDI in Canada. Since the implementation of the ICA and the net-benefit analysis in 1985, only three takeovers bids out of more than 1700 have been blocked. The ICA has been successful in attracting FDI, relative to global investment trends. In fact, **"**Although Canada's global share of foreign direct investment (FDI) has fallen, Canada's total stock of inbound FDI as a proportion of gross domestic product (GDP) is relatively high among industrialized countries, being more than twice the level in the US and over 12 times the level in Japan" (Wilson, 2008). Furthermore, "a recent Conference Board of Canada report indicates that, when the actual practices regarding foreign investment are taken into account, the impact of Canadian government intervention is not materially different from that of other industrialized countries" (Wilson, 2008).

Interestingly, the only three takeovers to ever be blocked under the ICA were blocked by the Conservative government of Prime Minister Stephen Harper, and all within a four-year period (between 2008 and 2012), and each time by a different Minister of Industry. The Harper government first blocked a foreign takeover in 2008 when it prevented United States-based Alliant Techsystems Inc. from buying Vancouver-based space technology firm MacDonald, Dettwiler and Associates for $1.3 billion. Then, in 2010, the federal government blocked BHP Billiton's $40-billion hostile takeover bid for Potash Corp. of Saskatchewan Inc. Finally, in 2012, Canada rejected Petronas' $5.9 billion bid for Progress Energy Resources Corp. until a few months later the takeover decision was appealed and approved. **"**Over the past number of years, there has been a slow escalation of the rigor of enforcement of the *Investment Canada Act* by the Minister of Industry, as evidenced by the increase in the length of reviews and the scale and scope of written undertakings that foreign investors were required to give the Minister to secure approval" (Borgers, 2008).

Unfortunately, both for the Canadian public's interest and those of private investors, it is impossible to understand why there has been a drastic escalation of blocked foreign takeover bids under the Harper government because the Minister responsible for the ICA is not required to disclose that information publicly. The fundamentals of the evaluation process remain the same. In other words, the core elements of the net-benefit analysis have remained unchanged since their inception in 1985. In fact, the former "significant benefit" test under the FIRA (implemented in 1973) and the current "net-benefit" test are almost identical. The only difference being the addition of a sixth criteria in the "net benefit" analysis, "the contribution of the investment to Canada's ability to compete in world markets." (Government of Canada, 2013). And, if anything, the new (lower) minimum thresholds for review have made it easier to approve takeovers, not harder. Therefore, the only reasonable conclusion is that the Harper Government was enforcing the same rules by a different measure, only we will never know what that measure was. Either that, or it is purely coincidental that the only three foreign takeover bids to be blocked since the inception of the Investment Canada Act in 1985, were blocked within four years of each other by the same political leadership. This trend toward “protectionism” could have negative implications for Canada’s ability to attract foreign direct investment in the future. It has certainly demonstrated the political ambiguity of Canada’s foreign investment review process.

It is too early to properly assess what approach the relatively new Liberal government, led by Prime Minister Justin Trudeau, will take in regard to FDI and the ICA. However, it is clear that Prime Minister Trudeau is pursuing free-trade with China and other markets, perhaps signaling an approach more similar to that of the Mulroney government than the economic protectionism associated with the Harper government or industrial nationalism associated with his father’s policies pertaining to FDI.

2.4.2 <u>The Influence of Federalism on Canada’s FDI Policy</u>

Given provincial constitutional authority for the “…development, conservation, and management of non-renewable resources” (Government of Canada, 2017e) under Section 92A of *The Canadian Constitution Act, 1982*, but federal constitutional authority for the “Regulation of Trade and Commerce” (Government of Canada, 2017e) and therefore, the evaluation of foreign acquisitions under Section 91 of *The Canadian Constitution Act, 1982*; there is inherent conflict in the separation of these powers concerning foreign acquisitions in the non-renewable resource sector. Provincial treasuries are most impacted by the acquisition of corporations in the non-renewable sector due to resource royalty rights that are constitutionally enshrined and yet provincial legislatures have no direct control of their sale.

Canada’s current foreign investment review process, conducted by the federal government, only takes into *consideration* the opinion of provincial legislatures. There is no requirement to adhere to the opinion of a provincial legislature on any foreign takeover. And yet, in the case of the attempted BHP Billiton takeover of PCS, Saskatchewan’s Premier, by employing several effective tactics, was able to successfully convince the federal government to block the bid. In the case of CNOOC takeover of Nexen, Alberta’s Premier Alison Redford supported the takeover, but demanded from Ottawa that it squeeze certain concessions from the acquiring Chinese SOE, even flying to China during the takeover period to discuss the bid that was eventually approved by the federal government. These two examples of executive federalism highlight the power of provincial premiers within the Canadian federation. In fact, one could argue that the federal government simply deferred to the provincial legislatures in both these takeover examples as the decision ultimately went in their favor. While this would be an over-simplification of the many factors that went into the federal government's ultimate decision in each respective case; there is no doubt that provincial political actors, their tactics, and public comments at the time, were crucial to the outcome of the federal government's decision.

While the provincial legislatures most affected in both the BHP-PCS and CNOOC-Nexen acquisitions were ultimately satisfied, the same may not occur during the next inevitable foreign takeover attempt of a major "Canadian" non-renewable resource company. The history of the Canadian federation is laden with examples of federal-provincial conflict when the issue involves resource policy, specifically non-renewable resource revenues. The "resource wars" of the 1970s and 1980s created animosity between the provinces and the federal government that linger to this day in Canadian political discourse, most recently as it pertains to the federal government's implementation of a national carbon tax. Saskatchewan Premier Brad Wall and other prominent Western Canadian politicians have likened the federally imposed carbon tax to the National Energy Program (NEP) imposed by the federal government in the 1980s. And even long before the implementation of the NEP, the federal government and the provinces were entangled in resource royalty and tax disputes. Ironically, as a result of these federal-provincial disputes, Saskatchewan nationalized its oil and potash industries, in part, as a means to retain royalties in provincial coffers prior to such rights being constitutionally enshrined in the Canadian Constitution Act, 1982. This action resulted in the creation of Potash Corporation of Saskatchewan (PCS), a Saskatchewan Crown Corporation, before it was privatized in the late 1980s. In fact, the "resource wars" of the 70s and 80s were simply a continuation of disputes over resource rights beginning in the 1930s with the passage of the Natural Resources Transfer Acts by the federal Parliament. Therefore, the history of the Canadian federation is wrought with examples of major resource related disputes between the federal and provincial governments. Foreign takeovers in an increasingly globalized economic environment represent a credible threat for future conflict. In fact, unless reforms are made to Canada's foreign investment review process, it is inevitable that there will be federal-provincial conflict in this crucial area of

Canadian public policy.

During the BHP Billiton hostile takeover attempt for PCS Saskatchewan's Premier Brad Wall was fully prepared for a major federal-provincial conflict and demonstrated this when he threatened a lawsuit against the federal government over lost revenue had the federal government approved the takeover. Therefore, had the federal government approved the BHP Billiton takeover of PCS there would have been a major federal-provincial conflict with no formal mechanism for recourse outside of the Courts. This is worthy of further consideration by policy-makers as these issues often concern national unity. So too is a policy that protects and ensures a provincial veto if the deal negatively impacts a provincial treasury by a certain objective measure. Provincial royalty revenue is not a criteria used by the federal government to evaluate foreign takeovers. The separation of powers between the federal and provincial governments in the Canadian Constitution stipulates that non-renewable resource revenue is a provincial right, and therefore the federal government does not evaluate foreign takeovers based on provincial revenue implications, in part, because they have no control over non-renewable resource revenue.

However, precisely because provincial resource royalty revenue provides such a major public benefit, the federal government should begin, under certain circumstances, deferring to provincial legislatures on matters concerning foreign takeovers that drastically impact their non-renewable resource revenue. As stated in section 20 of the Investment Canada Act (ICA) the federal government commits to "taking into consideration industrial, economic, and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment" (Government of Canada, 2013). Here, the Act should be more specific about provincial revenue losses being a factor in the federal government's analysis. In fact, the federal government should amend the ICA, or enact a policy, to ensure that the wishes of provincial legislatures are accommodated if their resource revenue is to be negatively affected by more than $200 million or 25% of the annual revenue of that resource.

In other words, under certain circumstances, the federal government should defer to the provincial government (s) whose revenues are most affected. In 2010-11, the year of the BHP Billiton takeover bid for PCS, potash revenues were $262 million (Saskatchewan, 2010). According to the Conference Board of Canada Report, the takeover bid would have cost the provincial government $200 million per year in lost revenue. "The reason is that through the acquisition, BHPB would be able to avail itself of favourable tax preferences. Acquiring an existing operation would allow BHPB to write off the capital cost of Jansen Lake against current income generated by PCS properties under the existing tax and royalty regime. In addition, the acquisition would allow the company to organize its affairs in such a way as to minimize corporate taxes paid to the Province" (Conference Board of Canada, 2010d).

Therefore, the federal government should have blocked the bid based on the loss in resource revenue to the Saskatchewan provincial government alone--only this criteria is not part of the current "net benefit" test. This policy of deferment would represent a more collaborative approach to federalism that would satisfy the province's Constitutional right to manage resource revenue and would ensure that resource revenue implications, a major public concern, become a fundamental consideration of any foreign acquisition in the non-renewable resource sector.

The criticism of such an approach would be that instead of amending the ICA or creating a new policy, a province could amend its royalty structure in order to compensate for the expected loss in resource revenue as a result of a proposed foreign acquisition. However, a royalty regime restructuring is a massive undertaking that rarely occurs because of the length of time it requires and the risk of catastrophic and unpredictable implications for subsequent investment in the province. It could also have negative consequences on investments already made, such as job losses, mine closures, etc. A royalty rate amendment can be a beneficial undertaking but it should not be done in haste, or employed as an emergency measure solely for the purpose of preventing or mitigating the affects of foreign investment during the finite processing window allowed for an acquisition allowed under the ICA.

Saskatchewan's Premier, Brad Wall, stated during the takeover bid for PCS that, "With or without the federal government, the mining license is here. We are finding out what leverage that gives us" (Francis, 2010). He further added that "No one can mine potash without a license from Saskatchewan" (Francis, 2010. Thus, had the takeover been approved the Premier intended to deny BHP Billiton the license to mine Potash. Whether or not he actually would or could have done so is another matter, but the consequences for Canadian federalism and national unity could have been profound. Given the propensity for conflict between federal and provincial governments over resource policy, Canadian policy-makers would be wise to pursue amendments to the ICA that allow for alternative dispute resolution outside the Courts and to simultaneously enact a policy that enables a greater level of provincial authority in foreign takeovers that most directly impact their treasury.

In terms of a mechanism for alternative dispute resolution, Canadian policy-makers should consider a quadruple dispute resolution framework. This framework, imbedded and formalized within the ICA, would mandate the interested parties (the province or provinces most impacted, the federal government, the acquiring company, and the company being acquired) to meet collectively and discuss the issues associated with the takeover.

2.4.3 The Influence of Partisan Party Politics On Foreign Direct Investment Policy

Foreign Direct Investment (FDI) policy in Canada has also been influenced by partisan party politics. Its influence is evident both in the formulation and in the implementation of foreign direct investment policy. Generally, the NDP has supported more protectionist FDI policies (e.g., their most recent opposition to CNOOC-Nexen takeover and the BHP Billiton-PCS takeover). Over time it has been quite consistent in articulating and defending this policy position. By contrast the other two major parties (i.e, the Liberal Party of Canada, and the various incarnations of the Conservative Party of Canada have fluctuated in their positions on foreign direct investment policy. The Liberal Party has fluctuated between protectionism (e.g. FIRA) under Prime Minister Pierre Trudeau and opposition to NAFTA under Prime Minister Turner, and free-trade policies pursued by Prime Minister's Chretien and Martin.

The PC Party, under Prime Minister Mulroney favoured a pro free-trade approach (e.g., ICA) that sought to avoid government interference in a shareholders right to profit and to simultaneously attract FDI. Surprisingly, the Conservative Party of Canada, led by Prime Minister Harper, took a protectionist, if not populist-based approach, when it became the first government to block a takeover bid since the implementation of the ICA in 1985 and did so on three separate occasions, including the BHP Billiton takeover bid for PCS. Additionally, the restrictions imposed by the Harper government on SOEs as a result of the CNOOC-Nexen takeover qualify as protectionist. It did, however, raise the threshold for review of foreign takeovers involving World Trade Organization WTO affiliated private enterprises, thereby reducing the federal government's ability to review or block a foreign takeover.

2.5 Key Issues Related to FDI & Foreign Takeovers

2.5.1 The Issue of Aboriginal People within the Context of FDI and Foreign Takeovers

A major policy challenge for Canada as it pertains to inward FDI and foreign acquisitions in the non-renewable resource sector is the impact of these investments, or takeovers, on Aboriginal peoples. Currently, the impact of a foreign takeover on Aboriginal people is not a factor in the federal government's evaluation process ("net benefit" test), representing a profound policy gap that requires immediate redress. As Prof. Ken Coates has argued in a recent policy paper, "Aboriginal people deserve a financial return from resource development in their traditional territories" (Coates, 2015). Furthermore, resource extraction and development activities are increasingly taking place near or on traditional First Nation lands. In Canada, "…there are 1,200 aboriginal communities located within 200 km of producing mines" (Fidler and Hitch, 2007). According to Amnesty International, "The vast majority of proposed resource development projects in Canada will affect lands and waters that are vital to the cultures and economies of First Nations, Inuit, and Métis peoples" (Amnesty International, 2016a). According to the Canadian Centre for Policy Alternatives, Aboriginal children in Canada are twice as likely to live in poverty as non-Aboriginal children. Lifetime incomes are substantially lower for Aboriginal people and education levels are significantly lower. There are numerous and complex reasons for these facts but they demonstrate a profound disconnect between Aboriginal people and the massive profits derived from resource extraction activities on or around their traditional lands.

Therefore, Canada's foreign investment review process could be another means by which the federal government moves toward greater reconciliation with Aboriginal people. According to the United Nations Special Rapporteur James Anaya, "Reconciliation…requires a more generous and flexible approach that seeks to identify and create common ground. Further, as a general rule, resource extraction should not occur on lands subject to aboriginal claims without… the free, prior and informed consent of the aboriginal peoples concerned" (Amnesty International, 2016a).

Aboriginal peoples have a unique and long-standing connection to the land upon which non-renewable resource development often occurs. "The Royal Commission on Aboriginal Peoples (1996) stated that "land is absolutely fundamental to aboriginal identity…land is reflected in the language, culture and spiritual values of all aboriginal people" (Government of

Canada, 2010). Most importantly, Indigenous sovereignty as it pertains to land title rights are increasingly being recognized by Canadian jurisprudence, creating greater certainty that economic development will require the consent of First Nations. Landmark court rulings in Canada are ensuring that corporate interests, both foreign and domestic, can no longer circumvent First Nations communities, their rights and interests. For instance, the Supreme Court of Canada, in 2014, ruled unanimously in favour of the Tsilhqot'in First Nation's land claim over a large area west of Williams Lake, B.C. Economic development, such as the construction of a pipeline, would henceforth require the consent of the Tsilhqot'in First Nation.

As legal precedent, such as that established by the Tsilqot'in decision is set, First Nation consent and formal engagement will become the norm, not the exception, and therefore, corporations and all levels of government, must recognize this reality through appropriate First Nation consultative and engagement practices. "Given historical ties to their lands, and given Supreme Court decisions that make it clear Indigenous peoples should benefit from the development of their territories, the sharing of money is a logical and almost unavoidable outcome of modern resource activity" (Coates, 2015).

Canada's foreign investment review process (currently the "net benefit" test) should therefore be modernized in order to accommodate these realities. A *"maximum benefit"* test would include the addition of criterions that accommodate the interests of Aboriginal peoples directly affected by any foreign takeover. As a result of this type of reformed evaluation process, the federal government could assess a foreign takeover based on the record of an acquiring corporation as it pertains to engaging, consulting, recognizing, and accommodating Aboriginal people and their land rights in other jurisdictions worldwide. The federal government could evaluate a foreign takeover based on the acquiring company's governance structure and its willingness or plans to include Aboriginal people in their workforce and upper-management positions responsible for Aboriginal engagement. The federal government could evaluate a foreign takeover on the undertakings promised by the acquiring company to local First Nations, such as jobs, revenue sharing, infrastructure, education funding and other promised programs and services. The point here is simply that the impact of a foreign takeover on Aboriginal people should be a factor in Canada's foreign investment evaluation process, particularly when the acquisition involves a non-renewable resource corporation on or near traditional Aboriginal land.

The often short-term and capital-intensive nature of resource development can be both beneficial and costly for Aboriginal communities impacted, depending on the specifics of the investment. In order for Aboriginal communities to maximize the benefits and mitigate the risks associated with non-renewable resource extraction activities, Impact and Benefit Agreements (IBAs) have become a more common industry practice. “IBAs are increasingly common and have evolved from simple socioeconomic contracts to more comprehensive agreements that consider multiple generations” (Fidler and Hitch, 2007). These agreements between industry representatives and the Aboriginal community impacted can help ensure labour provisions, economic development provisions, community provisions, environmental provisions, financial provisions, and commercial provisions, but such agreements are entirely voluntary. “The impetus for negotiating IBAs is project specific, but generally involves a decision to develop resources that require access to aboriginal lands or have an impact on aboriginal populations. Each IBA has distinct parameters but they principally operate on two premises: they address concerns of aboriginal people and provide benefits to aboriginal groups from mineral developments” (Fidler and Hitch, 2007).

One of the most appealing aspects of IBAs is that both Aboriginal communities and industry representatives are inclined to pursue them. “From a corporate perspective, IBAs align with corporate interests and operate on a business model whereby proponents complete IBAs to minimize risk and potential downstream project delays (i.e. costly litigation) and, in doing so, improve relationships with local residents and enhance their business reputation” (Fidler and Hitch, 2007). From the perspective of Aboriginal groups who sign IBAs, they are guaranteed certain benefits as they pertain to the development and use of resources on their land.

The policy challenges associated with foreign investment and foreign acquisitions in the non-renewable resource sector as they pertain to Aboriginal peoples include whether the acquiring foreign entities investing in Canada have the expertise or interest in accommodating Aboriginal communities generally, or specifically through IBAs (which are voluntary) or, whether the federal government should mandate such an agreement as a means to ensuring better outcomes for Aboriginal communities, and whether Aboriginal communities would perceive such well-intentioned federal support an infringement on their sovereignty. “Sosa and Keenan (2001) assert that the government should be engaged in IBA negotiations to ensure aboriginal people have financial resources and access to sufficient information to leverage a good deal” (Fidler and Hitch, 2007). To that affect, Canada’s foreign investment review, particularly when it concerns foreign takeovers, could ensure that the capacity for engagement with Aboriginal people is a key factor in the evaluation of any foreign takeover. Specifically, the federal government could ensure that new corporations or entities wishing to invest both have the organizational capacity to engage with Aboriginal people (i.e. through their organizational structure) or the federal government could require that they sign IBAs as a condition for investment approval. “Within Canada’s mineral-rich lands, IBAs offer a piecemeal approach to support aboriginal aspirations through negotiated agreements that address concerns through legally binding contracts” (Fidler and Hitch, 2007). Therefore, the addition of IBAs as a factor in Canada’s evaluation process of foreign takeovers could benefit Aboriginal communities most directly impacted by non-renewable resource development in accordance with their local needs and desires.

A major policy challenge in this area remains respecting Aboriginal sovereignty, while ensuring Aboriginal communities have the expertise and are aware of their leverage capacity in negotiating with foreign corporations. Regardless of the specific policy, based solely on the historic and contemporary relationship between Aboriginal people and their traditional land, the federal government ought to ensure Aboriginal people are a factor in the evaluation of foreign investments and acquisitions pertaining to the non-renewable resource sector. Corporations investing in Canada that are owned by foreigners with little to no knowledge or understanding of Canada’s Aboriginal peoples is a policy challenge that ought to be addressed in part by Canada’s foreign investment review process. A foreign corporation’s experience, capacity and willingness to engage respectfully with Aboriginal people could easily become one of the factors of the current “net-benefit” analysis. This amendment to the Investment Canada Act could lead to materially better economic and social outcomes for Aboriginal communities.

During the BHP Billiton takeover bid for PCS, Federation of Saskatchewan Indian Nations (FSIN) Chief Guy Lonechild stated in an Op-Ed, “…not enough has been said about the failure of governments to protect the mineral and resource interests of treaty First Nations in whose territories Potash Corp operates” (Lonechild, 2010). He further argued that, “The potash mining operations that have been operating since the early 1960s within treaties 4 and 6 have provided virtually no benefits to First Nations in the area” (Lonechild, 2010). It is important to reflect on the message from Aboriginal leaders that Aboriginal people are being left out of both the decision-making process when it comes to takeovers and the benefits derived from resource development as a result of such takeovers.

According to Chief Lonechild, “First Nations people are fed up with being considered afterthoughts in the development of our resources” (Lonechild, 2010). This, again, was the case during the BHP Billiton bid for PCS. Nowhere in the Investment Canada Act is there a mention of the Treaty rights or broader interests of Aboriginal communities that are disproportionately impacted by these decisions. In the Chief’s own words, “The issue of who owns Potash Corp is less important than how all citizens of the province, including its First Nations, can share in the future development of these shared assets” (Lonechild, 2010). In other words, policy-makers should focus more on how those directly impacted by takeovers in the non-renewable resource sector can *maximize the benefit* of such investment.

During the takeover controversy, PCS released their “Pledge to Saskatchewan” document, and one of its seven commitments to the people of Saskatchewan was the “Development of a Strong Aboriginal Workforce” (Government of Saskatchewan, 2010) which included a promise to develop “…an Aboriginal Engagement Strategy to build mutually beneficial relationships with Aboriginal communities, encouraging increased employment, economic development and community building” (Government of Saskatchewan, 2010). PCS further acknowledged that, “The execution of this strategy is integral to the development of the Province, the company and Aboriginal communities” (Government of Saskatchewan, 2010). In essence, PCS agreed that the lack of engagement with Aboriginal communities was a concern that needed to be addressed going forward. Therefore, both industry and Aboriginal leadership were supportive of greater collaboration and engagement with Aboriginal communities throughout the BHP-PCS takeover controversy. While the provincial government “welcomed” the PCS Pledge to Saskatchewan, it could have made the well-being of Aboriginal people a significant issue in the takeover bid. Only the federal government was silent on the issue.

It is therefore apparent that Canada’s policy on foreign takeovers in the non-renewable resource sector should, at the very least, include an analysis of the impact of these deals on Aboriginal communities and should, in consultation with them, attempt to leverage the best deal possible for Aboriginal people. This could be achieved by making corporate undertakings to Aboriginal communities a key factor in the approval process. This objective could also be achieved by mandating IBAs. Under such a modernized “net benefit” test (a “maximum benefit” test), foreign takeovers could be blocked if an acquiring corporation demonstrates a lack of respect for Aboriginal people or their communities in their operations abroad. The objective of these reforms would be improved standards of living for Aboriginal people in Canada, but could also result in the better treatment of Aboriginal people abroad.

2.5.2 The Issue of Environmental Protection and FDI and Foreign Takeovers

Foreign direct investment, while evidently beneficial, comes with major policy challenges that are unique to the non-renewable resource sector. The environmental impact of Canada's non-renewable resource sector is one such policy challenge that is currently unaddressed by Canada's current foreign investment legislation. Canada currently does not evaluate foreign takeovers based on any assessment of environmental impact. This is so, despite the fact that Canada's non-renewable resource sector is a significant contributor to environmental damage and global Greenhouse Gas Emissions (GHGs). For instance, "…while Canadians make up only 0.5 per cent of the global population, Canada's share of global greenhouse gas emissions is approximately two per cent" (CAPP, 2017d). This means Canada is one of the worst per-capita emitters of GHG emissions on the planet. The Oil and Gas sector is the largest source of GHG emissions in Canada, accounting for 26% of total emissions (Government of Canada, 2016). Furthermore, "The increase in GHG emissions between 1990 and 2014 was mostly due to a 79% increase in emissions in the oil and gas sector" (Government of Canada, 2016). The oil sands alone, "…account for 9.3 per cent of Canada's GHG emissions and about 0.13 per cent of global GHG emissions" (Government of Canada, 2016).

At 2%, Canada's total share of global GHG emissions is small relative to countries with larger populations. Global share of GHG emissions amongst the largest contributors are as follows: China (24.5%), the United States (14%), and India (6.7%) (Government of Canada, 2016). However, Canada's per capita GHG impact is ranked 3rd worst of all GHG emitting OECD countries. Of all OECD member countries, Canada's per capita GHG impact is only slightly less than the U.S. and Australia. Therefore, Canada is internationally regarded as one of the top (per capita) GHG emitters on the planet. This fact requires, at the very least, Canadian policymakers to consider the environmental impact of FDI, particularly as it pertains to foreign acquisitions in the non-renewable resource sector. As demand for Canadian non-renewable resources is expected to grow, policy-makers must attempt to mitigate the environmental impact of such development.

As global demand for energy continues to increase, "Greenhouse gas emissions from the oil sands, Canada's fastest-growing source of GHGs, are projected to increase by 124 per cent between 2010 and 2030…" (Fekete, 2016). This increase would bring the oil sands share of national GHG emissions up to 14% by 2030 for its current share of approximately 9% in 2016 (Fekete, 2016). Compounding the policy challenge is that Canada's oil sands are considered the most energy intensive source of oil in the world. "A study prepared for the European Union determined that production in the oil sands results in 22 per cent more emissions than is the standard for EU fuels" (Cryderman, 2013). This is consistent with recent U.S. Congressional findings that claim Canada's oil sands produce up to 20% more GHG emissions" (Lattanzio, 2014).

Industry representatives contend that a "well to wheel" analysis tells a different story. "Overall, oil sands crude is around six per cent more GHG intensive than the U.S. crude supply average on a wells-to-wheels basis" (CAPP, 2017c). Oil sands proponents argue that a well-to-wheel analysis is crucial because shipping oil by tanker, for instance, can significantly increase emissions. For example, Trans-Canada Corporation and the U.S. Department of State have made the case that the Keystone XL pipeline (from Alberta to Texas) would offset up to 200 ocean tankers a year. "This equates to lowering greenhouse gas emissions by 19 million tones" (CAPP, 2017d). Either way, Canadian policymakers must begin considering the environmental impact of the non-renewable resource sector in its evaluation of foreign takeovers.

Canada's current evaluation process for foreign acquisitions does not consider the environmental impact of these deals at all, while the evaluation regime of other non-renewable resource dependent countries, such as Australia, does. The Canadian federal government could evaluate a foreign takeover, in part, based on the environmental record of a foreign acquirer. It could evaluate a foreign takeover, in part, based on the current environmental policies of an acquiring company and their plans for carbon reducing strategies, or perhaps their propensity to invest in clean technology or research to that affect in Canada. If the federal government wanted to it could even evaluate a foreign takeover on whether the acquiring company supports a certain price on carbon.

2.5.3 The Issue of Transparency and Accountability in FDI and Foreign Takeovers

Canadians deserve a more transparent and accountable process in the evaluation of foreign takeovers. Currently, there is no requirement in current legislation that the Minister must disclose the rationale for their decision. This is bad public policy for Canadians and foreign investors alike--both desire and deserve a transparent, comprehensible, and accountable process for the evaluation of foreign takeovers. “In the fast-moving world of modern business, where significant investment decisions are made on a global basis, regulatory clarity and administrative efficiency are among the significant factors considered by foreign investors.” Currently, Canada’s evaluation process for foreign takeovers is ambiguous, ripe for political exploitation, and therefore requires clarity.

In 2007, the Minister of Industry, the Hon. Jim Prentice announced the creation of the Competition Policy Review Panel. This Panel was mandated to “review Canada’s competition and foreign investment policies and to make recommendations to the Minister of Industry, on behalf of the Government of Canada, for making Canada more competitive in an increasingly global marketplace” (Wilson, 2008). The Panel discovered through broad consultations with industry stakeholders that “…a key objective of the changes to the ICA should be to improve the transparency, predictability and timeliness of decision making in the review process. We recommend requiring ministers to report publicly on the disallowance of any individual transaction under the Act and, in doing so, to give reasons for the disallowance. The current inability of ministers to articulate the reasons for allowing or disallowing a foreign investment proposal does not meet contemporary standards for transparency” (Wilson, 2008).

Therefore, a report commissioned by the Minister responsible for the ICA, concluded that the ICA process is currently not transparent *and* that the Minister responsible for the ICA should be required to publicly disclose their rationale for any decision regarding a takeover bid. However, these recommendations have not been implemented. Instead, Canada’s foreign investment review process remains intentionally vague so that decisions can be made for overtly political reasons. This policy is not in the best interests of Canadians, but instead suits the short-term political interests of decision-makers. The Panel recommended “…ministers should publish annually a report on the operation of the ICA. The annual report should provide information on the development of any new policies or guidelines as well as an overview of all transactions subject to the ICA and undertakings provided by foreign investors in relation to the disallowance test under the legislation. The report should be required to provide sufficient detail, without breaching commercial confidences, to allow the Canadian public to assess whether the Act is meeting its objective of ensuring that foreign investment proposals are not contrary to Canada’s national interests” (Wilson, 2008). To date, these recommendations have not been implemented.

A criticism of requiring the Minister to publicly disclose their reasoning with regards to a takeover bid decision is that this could put the investor in a disadvantageous position. Specifically, the argument here is that the investor could be required to disclose information that would be made public when the takeover is either approved or denied that is sensitive to their business interests. However, the Panel, mostly consisting of industry stakeholders, addressed this issue and concluded that the government could release the reasoning for a decision without sacrificing “commercial confidences” (Wilson, 2008).

Without a requirement of the Minister responsible for the ICA to disclose the rationale for their decision with regards to a takeover bid, there can be no accountability for Canadians when it comes to foreign takeovers. Without knowing why a takeover was approved or denied, the Canadian public cannot adequately ensure that the government enforces the commitments it received from an investor when approving a takeover bid; private investors will not know why a decision was made; the public will not be able to hold its own government, or the investor, to account if commitments are not met after the fact. The issue of transparency is therefore of serious concern to Canadians and investors alike.

During the CNOOC-Nexen takeover bid, Premier Alison Redford was apparently pushing for tougher conditions including 50% board and management positions to be held by Canadians, maintaining workforce levels for five years after the takeover, and maintaining capital spending plans. If these conditions were in fact part of the approval process, Canadians may never know. Meanwhile, since the takeover, Nexen has cut between 500-1,000 jobs. “CNOOC started laying off employees as soon as it took control, resulting in a climate of fear about who will be next, according to several current and former employees interviewed” (Cattaneo, 2014). Furthermore, “…Chinese control has tightened with the arrival last summer of Fang Zhi as CEO. He replaced Kevin Reinhart, who was unceremoniously ousted last April after helping secure the deal” (Cattaneo, 2014). “In addition, about half of the company’s senior executives at the time of the takeover are no longer with the company…” (Cattaneo, 2014).

This means that CNOOC may not have fulfilled their obligations to Canadians. In response, the federal government stated that, “…it’s watching the company’s progress and warned in a statement that CNOOC’s commitments under the Investment Canada Act are legally binding” (Cattaneo, 2014). The Investment Review Division of Industry Canada monitors compliance with commitments by foreign corporations. Performance evaluations are conducted 18 months after the takeover has occurred. Any failure to comply with promises made on the part of the investor can result in numerous penalties, including forced divestiture. “Legal proceedings could be initiated with the application for a court order to force compliance. A court order, if issued, could direct the investor to relinquish control of the Canadian business or to comply with agreed-upon undertakings, or it could impose a financial penalty” (Library of Parliament, 2014). However, such enforcement is extremely rare, in part, due to the lack of transparency in the Act. If Canadians do not know what deals were made, there is significantly less political pressure for federal politicians to enforce measures.

Jake Enwright, a spokesman for former Industry Minister James Moore, stated that, “Our Government is the only government in Canadian history to take a company to court to ensure ICA commitments are fulfilled” (Cattaneo, 2014) referring to the 2007 takeover of Stelco Inc. by U.S. Steel. This demonstrates the rarity of such an occurrence, which is troubling given the examples of foreign takeovers that fail to provide a net-benefit to Canada in the long term. Furthermore, the government has now changed, and no further legal action has been taken. “It has been reported that Industry Canada declined to pursue foreign mining companies Vale, Xstrata and Rio Tinto for apparent breaches of employment undertakings related to their acquisitions of Canadian mining companies — respectively, Inco, Falconbridge and Alcan — although the undertakings have not been made public, and so we are unable to confirm their actual commitments. All these foreign mining companies made significant job cuts to their acquired Canadian businesses in 2009” (Hoffman 2010). If Canadians knew the details of these takeover decisions, both the acquiring corporation and the federal government would be more accountable and more inclined to follow-through on commitments.

In his opposition to the BHP Billiton takeover bid of PCS, Premier Wall also made the point that Canadian businesses that had been acquired by foreign entities had not kept their commitments. “The federal government extracted a promise that no jobs would be cut and the promise was broken. With Vale of Brazil, commitments were made that staffing would be maintained after purchasing Inco. In March of '09, 463 jobs were cut, and I'd say the promise was broken. Rio Tinto promised not to cut jobs or operations when it took over Alcan. Hundreds of millions of dollars in cuts to scheduled upgrades to smelters in Quebec and BC occurred then thereafter, and 300 jobs were cut, including 18% of the head office at Alcan” (Wall, 2010). In other words, Premier Wall was stating that foreign takeovers should not be approved based on commitments, or “promises” because either a) the federal government cannot be trusted to enforce these deals or b) the private sector cannot be trusted to keep their promises. While his scepticism appears warranted, it would seem more effective to express such scepticism and appeal for reform of the Investment Canada Act in a manner that would give the federal government more enforcement power. The mandatory public disclosure of any review decision would be a reasonable argument to make. This change to the ICA, coupled with the other policy reforms discussed in this chapter such as a triple-bottom line net-benefit analysis (environmental, social, economic), would allow the Canadian public to fully *maximize the benefits* associated from foreign takeovers and FDI.

CHAPTER 3: UNDERSTANDING THE BHPB TAKEVOER BID OF PCS

3.1 The BHPB Takeover Bid of PCS: A Background

On November 3rd, 2010, federal Industry Minister Tony Clement announced that the Government of Canada had denied the $38.6 billion hostile takeover bid by Australia-based BHP Billiton (BHPB) for the Potash Corporation of Saskatchewan (PCS), which had 49% Canadian ownership (Coyne, 2013). The decision to block the sale of the largest resource corporation in Saskatchewan was based on a “net-benefit” analysis, a requirement of the Investment Canada Act which, at the time, allowed the federal government to block any deal worth $330 million or more if the bid does not provide a "net-benefit" to Canada. The decision set a new precedent for Industry Canada, which had until then approved all but one out of more than 1,600 takeovers of Canadian firms since the Investment Canada Act came into effect in 1985.

The federal government’s decision to block the takeover bid appeared to be a reversal of the government’s initial position. On Oct. 20, 2010, Prime Minister Stephen Harper told the House of Commons that the takeover bid was a "proposal for an American-controlled company to be taken over by an Australian-controlled company" (CBC, 2010a). This statement by the Prime Minister led many to infer that the federal government was downplaying the sensitives associated with the takeover and would therefore approve this bid as it had done in 99% of previous cases. All major federal political parties supported the government’s decision to block the takeover bid and the response by Saskatchewan’s Premier Brad Wall to the final decision was very positive: “Let me just say that, quite unequivocally, Canada works. Canada works for the regions. In this case it has worked, to a great extent, for the people and the province of Saskatchewan” (CBC, 2010b). However, the federal government’s reasons for blocking, what would have been the largest foreign takeover in Canadian history, remains unclear and unconvincing.

The four objectives of this chapter are: first, to explore the historical context in which the takeover bid arose and was ultimately blocked; second, to examine the reasons for the Government of Saskatchewan’s opposition to the hostile takeover bid, and the tactics it employed to oppose it; third, to examine the criteria and rationale the federal government used in not approving the hostile takeover bid; and fourth, to consider the implications of the federal government’s decision not to approve the hostile takeover bid.

3.2 <u>Historical and Jurisdictional Context</u>

It is not uncommon for premiers of Western Canadian provinces to defend vigorously the financial interests of their province when challenged by the federal government or private sector corporations. This is evident in the disputes between federal and provincial governments that occurred during the “resource wars” of the 1970s and 80s. The implementation of the *National Energy Program*, intrusive federal tax policies, and the *Oil and Gas Conservation, Stabilization and Development Act,* triggered a constitutional war between the federal and provincial governments over the right to natural resource revenues. Ironically, one of the products of those “wars” was the creation of PCS as a Crown corporation to control potash production in the province of Saskatchewan, until it was fully privatized in 1990. Therefore, as Saskatchewan’s former NDP Finance Minister Janice MacKinnon aptly put it, “Had the leadership of BHP studied the politics of potash in Saskatchewan it might have avoided the serious strategic mistakes that cost it the support of the Wall government for its takeover bid” (MacKinnon, 2010).

The Progressive Conservative Party of Saskatchewan, led by former Premier Grant Devine, was responsible for the privatization of Potash Corporation of Saskatchewan in the late 1980s. Premier Brad Wall, whose political career began with the PC Party, was working for that party at the time of the privatization of PCS, as a Ministerial Assistant. He also ran unsuccessfully for the PC nomination in Swift Current in 1991. Four Progressive Conservative MLAs then joined ranks with four Liberal MLAs in the early 1990s to create the Saskatchewan Party, the party Premier Wall now leads. A contentious decision at the time, the privatization of PCS would become an abject failure if PCS were to be acquired by another company with its corporate headquarters outside the province. Therefore, the political history of the province makes it near impossible for a non-Canadian entity to acquire PCS, particularly when the bid is hostile and the successor of the PC party is in power. And thusly, BHP Billiton would have had to offer a very beneficial deal not just to PCS shareholders, but, more importantly, to the people of the province of Saskatchewan. This they did not do publicly until it was too late.

One of the lingering outcomes of the “resource wars” of the 1970s and 80s is “Western Alienation”, the sentiment, caused by federal government policies and actions, that the federal government prioritizes central Canadian interests at the expense of western Canadians and their public and private finances. The Conservative Government of Prime Minister Stephen Harper in power at the time of the BHP Billiton takeover bid for PCS was all too aware of these concerns, having its political roots in the Reform Party and its successor the Canadian Alliance that began, in part, as a result of federal policies that perpetuated western alienation, including the NEP (National Energy Program). Prime Minister Harper, himself, was originally elected as a Canadian Alliance representative of the Calgary Southwest constituency in Calgary, Alberta in the 37th Parliament of Canada.

Furthermore, 13 of the 14 MPs representing Saskatchewan at the time of the proposed takeover were Conservative. While they were heavily criticized for their silence during the takeover controversy, their caucus did play a key role in advocating for Saskatchewan’s interests behind closed doors. All 13 MPs lobbied the Minister of Industry on the issue and met with Premier Wall and his Minister of Energy, the Hon. Bill Boyd in Ottawa. But according to SK’s lone Liberal MP, the Hon. Ralph Goodale, the 13 Conservative MPs were not always against the bid, "The one I heard precisely was, 'What do you care, Ralph? It's just an American company.' And that really, I think, tells you where they were at.” (Vanderklippe, 2012) One Conservative MP Tom Lukiwski stated, “All of us, including myself, from time to time we'd go back and forth and back and forth…I can certainly argue both sides of this issue very easily" (Vanderklippe, 2012). Even though the Saskatchewan provincial government would have benefitted from the vocal opposition of the 13 MPs to the takeover bid, the province never complained about their silence on the issue and Minister Boyd even stated, "I believe they put forward a position that agreed with the position that the province took" (Vanderklippe, 2012).

It is reasonable to conclude that the 13 Conservative MPs representing Saskatchewan at the time of the attempted takeover of PCS were sympathetic to western Canadian issues and inclined to adhere to the concerns of Saskatchewan’s Premier Brad Wall, particularly given the synergies in political ideology between the federal and provincial governments in power. i.e. both parties were centre-right and had a vested interest in each other’s political success, particularly in a federal election year. Given the political and historical origins of both the Conservative Party in power at the time, and the considering the issue itself concerned resource revenues, it is not surprising that the federal Conservative government would adhere to the objections of a popular western Premier with similar political affiliations. For, only when Premier Wall voiced his concerns about the takeover did the federal government change their tune. Had it been an NDP Premier making the case for Saskatchewan’s interests to a Conservative federal government, the outcome could have been very different. "When the story first broke, it seemed like a story - that these things happen and it goes to the shareholders and the shareholders either approve or disapprove," said Andrew Scheer, the Conservative MP for Regina-Qu'Appelle (Vanderklippe, 2012). What changed their mind was Premier Wall's public opposition to a takeover bid that occurred within six months of the 2011 federal election at a time when the Conservatives had a minority government.

The BHPB bid raised, once again, the issue of the federal government's legal authority, under Section 91 of the *Constitution Act, 1982*, to oversee "the Regulation of Trade and Commerce" and the province's exclusive authority over the "…development, conservation and management of natural resources…" under Section 92A of the *Constitution Act, 1982*. Although there is obvious potential for federal-provincial conflict given the federal and provincial powers under Sections 91 and 92A of the *Constitution Act, 1982*; Section 92A (3) of the *Constitution Act, 1982* states, "…where such a law of Parliament and a law of a province conflict, the law of Parliament prevails to the extent of the conflict" (2017e). Therefore, while Saskatchewan could not have vetoed the bid, it had the power of political influence demonstrated time and again by various premiers throughout Canadian history during the 1930s (Natural Resources Transfer Agreement), the "resource wars" of the 70s and 80s, and Quebec sovereignty disputes. Using that power, Saskatchewan became the first province since the implementation of the *Investment Canada Act* in 1985 to protest a foreign takeover bid and successfully convince the federal government to block the bid.

In order to properly "manage" the potash industry in Saskatchewan, the province wanted to ensure it benefited from significant royalty revenues, a potash company with headquarters situated in the province, and a corporation willing to invest heavily in communities across the province. The federal government, which had legal authority to approve or deny BHPB's $38.6 billion dollar hostile takeover bid of PCS pursuant to powers defined in the *Constitution Act, 1982* would have to approve or deny the bid based on six criteria in the *Investment Canada Act*, known as the "net-benefit" test.

3.3 Why and How did Saskatchewan Oppose the Takeover Bid?

Premier Brad Wall and the Saskatchewan Party government first spoke out against the bid on October 21 nearly two months after BHPB announced its $38.6 billion all-cash offer to acquire PCS. Premier Wall based his government's opposition to the bid on a Conference Board of Canada Report commissioned on September 2nd by his government. The Conference Board of Canada was asked to "assess the risks and opportunities associated with a possible takeover of Potash Corporation of Saskatchewan (PCS)" (2010d). In its executive summary, the report outlined the main corporate takeover effects (CTE's) and the wide range of policy levers the province of Saskatchewan had at its disposal to minimize risks and maximize opportunities both during and after the bid process.

The province's decision to fund the Conference Board of Canada Report was effective on two fronts. Firstly, the Conference Board of Canada is a not-for profit Canadian organization that does not lobby for specific interests and is funded exclusively through the fees it charges for its services. Therefore, the report gave the Government of Saskatchewan a credible "third-party" opinion on the hostile takeover bid. The recommendations of its report, which were made public on October 1, were widely seen as legitimate and unbiased.

Secondly, the report provided an analysis of the hostile takeover bid based on the potential impact on the provincial treasury. The authors of the report noted: "We calculate that the negative fiscal impact to the Province would be about $200 million per year over a 10-year period, for a total of $2 billion—equivalent to approximately two per cent of the Province's annual revenues" (2010d). The negative fiscal impact on the provincial treasury provided Premier Wall with substantial cause to make his case against the bid.

In making his case against the approval of the BHP Billiton bid, Premier Wall also relied heavily on the argument that Canadians must protect their mineral resources from foreign takeover. He invoked this argument on many occasions, including in response to comments made by former BHPB Chair Don Argus. On that occasion Premier Wall argued, "…it's up to our federal government to ensure we retain Canadian control of our natural resources and that we don't become a "branch office", like BHP apparently sees us" (Graham, 2012). Premier Wall also vigorously defended Potash as a "strategic" resource. "We all know that arable land is actually decreasing in supply, because of urban sprawl and population growth. We know that countries are getting hungrier, that the protein intensity of diets is increasing and therefore agricultural intensity will be also on the rise up. We know then that this amazing nutrient we have in such great abundance in the province, this potash, is going to be in greater supply. It is a *strategic resource*. And we should act like it. The country should act like it" (2010c).

The Government of Saskatchewan's net-benefit analysis included three components: 1) the "strategic" element of the resource, 2) jobs, and 3) revenue. These criteria were created as a result of the takeover bid, not in advance of it, and put the province's assessment criteria at odds with that of the federal government. In terms of revenue, the province expected a significant loss from royalties—$200 million per year based on the Conference Board of Canada's analysis. And, perhaps most importantly, Premier Wall declared Potash a "strategic resource". This did not mean that it was off-limits to foreign investment, but rather, that PCS, which owned nearly 30% of global reserves, was. Thus, based on their own criteria, the BHP Billiton bid for PCS was deemed insufficient by the province of Saskatchewan.

BHP Billiton's initial public notice of its hostile takeover did not commit to significant undertakings such as greater provincial revenues, corporate social responsibility, the protection of jobs or the movement of jobs other than top executive positions. It also proposed to operate outside of Canpotex. Instead of focusing on public undertakings that would substantially benefit the people of Saskatchewan, BHP Billiton focused primarily on shareholder premiums, the majority of whom lived outside of Canada. This was a strategic mistake and demonstrated a lack of understanding as to the public significance of PCS to Saskatchewan. The PCS Board responded to BHP Billiton's offer in a public letter on August 17th, 2010. The Board and management unanimously rejected BHP Billiton's offer having concluded that the proposed offer "grossly undervalues PotashCorp and its strong prospects for continued growth and shareholder value creation" (Howe, 2010). Interestingly, the share price of PCS has plummeted by approximately 50% since the hostile takeover bid was announced in 2010. Thus, PCS shareholders are arguably the biggest losers as a result of this failed takeover as they were offered a 20% premium on the share price at the time of the proposed takeover.

In addition to Premier Wall's compelling arguments against the BHPB bid were several effective tactics he used to influence the federal government's final decision. He targeted and won the support of the four premiers from the provinces of Manitoba, Alberta, Quebec and New Brunswick, all of whom were strategically chosen for their respective influence within the Canadian federation. Manitoba, Saskatchewan and Alberta represented a united front as the resource-rich Prairie Provinces. Alberta's Premier Ed Stelmach compared the takeover of PCS to "all oil companies in Alberta being bought by one large oil company" (Stelmach, 2010). Manitoba's Premier, Greg Selinger, was concerned about the "strategic" nature of the resource. New Brunswick represented both a maritime province and the only province with a PCS mine outside of Saskatchewan. Arguably, Quebec was targeted for the substantial political influence it exerts within the Canadian federation. Quebec's Premier, Jean Charest, opposed the takeover because he believed it did not provide a "net-benefit" to Canada. Premier Wall also sought the advice of former SK Premiers, Roy Romanow (NDP), Grant Devine (PC) and former Alberta Premier Peter Lougheed (PC) all of whom, in his own words, "…managed these issues better than any other Premier" (Francis, 2010).

Premier Wall also threatened a lawsuit against the federal government with the intention of reclaiming any lost revenue as a result of the proposed takeover. "If they want to make this deal, then they can indemnify the province of Saskatchewan against the costs," Wall said (Hansard, 2010). "It will be Ottawa's deal, not Saskatchewan's deal, and the people of Saskatchewan will not be on the hook for it" (Hansard, 2010). This was far from the conciliatory approach the Premier and his government had taken to its relations with the federal government on other federal-provincial matters, including "equalization returns", since the Saskatchewan Party's election in 2007.

In its opposition to the bid, the Saskatchewan Party government received substantial criticism from business and political commentators in Canada and around the world. For example, a columnist for *The National Post* suggested Premier Wall had become the world's next Hugo Chavez. "Mr. Wall touched on all the bases you would expect from the leader of, say, Venezuela" (Corcoran, 2010). The columnist's opinion was indicative of the claim made by other pundits from across Canada that Saskatchewan was shutting its doors to the benefits of foreign investment and sacrificing the country's investment-friendly reputation.

Even the Conference Board of Canada report that was commissioned by the province of Saskatchewan, warned that "formal provincial opposition to the acquisition of PCS by a private resource company would be seen as undermining the rights of shareholders to sell their PCS shares to the highest bidder" (2010d). To this warning, the Premier responded through an effective province-wide radio message that became a mantra throughout his campaign against the takeover bid: "Private companies like BHP Billiton will act in the best interests of their shareholders, as they should. Meanwhile, Saskatchewan must act in the best interests of its shareholders, the people of the province of Saskatchewan" (2010c). This important distinction between the role of a government and that of private shareholders of a corporation proved to be a very effective way of engaging Saskatchewan citizens in the BHPB debate and encouraged them to support the provincial government's position. Having been elected on a free-market agenda, Premier Wall also defended his government's principles. "To be pro-market and pro-free trade does not necessarily mean you can't make some strategic decisions when it comes to the control of your natural resources" (Republic of Mining, 2010c). Premier Wall also made the effective argument that there is precedence for "enterprise friendly" governments blocking foreign takeovers in free-market economies. The Premier specifically referred to Australia as an example of a country with a free-market economy blocking a takeover bid for strategic reasons. This was all the more effective because BHP Billiton is an Australian-headquartered company.

> "*And let me just say this, the answer no is not unprecedented. It has been given in free market economies around the world. Here is an example from Australia, the home of BHP Billiton. When Shell bid $10 billion for a controlling stake in a leading company developing Australia's offshore natural gas reserves, an answer came from the enterprise-friendly government of Prime Minister John Howard in April of 2001, and that answer was a respectful no. Not yes with conditions, it was no. Australia's then-treasurer Peter Costell said it was in the country's best interests to have these offshore reserves to be quote "unequivocally managed and operated and marketed for Australia. Why in the world should we deserve anything less than that in Saskatchewan and in Canada?*" (Republic of Mining, 2010c).

Within the province of Saskatchewan, Premier Wall was not alone in his defense of Saskatchewan's controversial position. One of Saskatchewan's most influential political commentators, Murray Mandryk, agreed that the enormous impact of potash revenue on the provincial treasury, and the strategic importance of the resource in regards to Canada's future food and energy security, made BHP Billiton's 38.6 billion hostile takeover of PCS "more than a right-wing philosophical debate over some distant shareholder's right to profit as much as he or she pleases" (Mandryk, 2010).

The popularity of both Premier Wall and his governing party increased during the BHPB takeover bid. A poll by Sigma Analytics, conducted just days before the federal government decided to block the bid on November 4th, reported Premier Wall's Saskatchewan Party government had the support of 57.3 per cent of voters, a gain of more than six points over the party's performance in the 2007 provincial election and well ahead of the official opposition NDP at 29.4 per cent. The same poll discovered that 73 per cent of respondents believed that Premier Wall was best fit to lead the province compared to 17 per cent for the leader of the official opposition, Dwaine Lingenfelter (Grenier, 2010).

Taking an adversarial approach to relations with the federal government has had significant political benefits for numerous provincial premiers. Newfoundland and Labrador's Premier Danny Williams was well known for the disputes his government waged with the federal government over rights to offshore oil revenues and, largely as a response, his approval ratings consistently hovered between 70 per cent and 80 per cent (Williams, 2010). After the 1980 Quebec Referendum, Premier René Levesque's PQ Party increased its share of the vote in the 1981 provincial election from 41 per cent to 49 per cent. Furthermore, in the 1982 Alberta provincial election, immediately after the National Energy Program dispute, Alberta Premier Peter Lougheed's PC party won 75 of 79 seats in the Alberta legislature and increased its total share of the vote by 7 per cent from the previous election.

However, there is no direct causal relationship between a premier's popularity and the extent to which a premier critically engages the federal government in the public realm. Popularity in the polls depends on numerous factors including the political climate within the province at the time of the dispute, and whether or not a Premier can favorably engage the public on the issue itself. Saskatchewan's former Premier Lorne Calvert was seemingly unable to engage provincial citizens during the federal-provincial dispute over equalization payments in 2007. Premier Calvert's NDP government lost the provincial election later that year by a significant margin of 18 seats in the Saskatchewan legislature. As Saskatchewan's former NDP Finance Minister Janice MacKinnon put it, "the call for $800 million more in equalization funding at a time when the province is booming is at the very least confusing" (MacKinnon, 2007).

Premier Wall's popularity was also, in part, a result of an ineffective political opposition at the time of the takeover bid. NDP leader and leader of the opposition, Dwaine Lingenfelter, a former VP of International Relations for Nexen Inc. opposed the BHP Billiton takeover bid for PCS but did so ineffectively. His proposals received criticism from Saskatchewan's foremost political columnist and commentator, Murray Mandryk. "Of course, to capitalize on this issue would have required Lingenfelter saying something substantive about protecting potash resources, controlling production or instituting a new tax and royalty structure -- preferably, something that went well beyond Wall's own pronouncements two weeks ago. That didn't happen" (Mandryk, 2010). Mandryk specifically criticized Lingenfelter's call for public hearings on the takeover at the Legislature. "Instead, his priority would be politically charged hearings in the legislature that would serve little purpose other than providing a forum for the unions to happily repeat Lingenfelter's nonsensical, biased rhetoric that if we had only held on to that Crown Potash Corporation we sold in 1989 for $630 million we could privatize it for $38.6 billion right now" (Mandryk, 2010).

In response to Lingenfelter's comments about the sale of PCS, Energy and Resources Minister Bill Boyd accused Lingenfelter of mismanaging PCS by giving away the government's "golden share" in the company in 1994. The golden share legislation required 55% of PCS shares to be owned by Canadians and the majority of directors to be Canadians as well, including three from Saskatchewan. However, as Saskatchewan business commentator Bruce Johnstone put it, "…Boyd knows full well that such restrictions only depress the price of the stock and artificially keep companies in Canadian hands. The reality is that, once a Crown corporation is privatized, it quickly becomes owned by private investors, foreign and domestic. What nationality they belong to is of little consequence to the operation or direction of the company itself" (Johnson, 2010). Whether it is true or not that ownership nationality is irrelevant or that golden shares artificially depreciate a company's worth is debatable, but these were the public opinions of a respected and influential business commentator during the takeover controversy.

Premier Wall was successful in his attempt to win public support within the province of Saskatchewan because of the political climate at the time and the precise nature of the issue. The future of, arguably, Saskatchewan's most strategic resource, a former Crown – and the issue of who controls it and how much revenue will be derived from it were at stake. The BHPB bid for PCS occurred in the wake of a 2010 provincial budget in which potash revenue had fallen nearly $1.5 billion short of the previous year causing the Government of Saskatchewan to return nearly $200 million to the industry (Blackwell, 2010). Saskatchewan citizens were therefore all too familiar with the impact of potash revenue on the provincial budget and their quality of living to ignore Premier Wall's case against the bid.

The political strategies and substance of Premier Wall's opposition to the takeover served the political goals of his party, his leadership, and the interests of the province itself. A consequence of the federal government's decision is a new precedent for federal-provincial relations that could lead to a greater decentralization of the Canadian federation. Will or should the federal government now defer to all provincial premiers who claim a foreign takeover of a "strategic resource" does not provide a "net-benefit" to their province? To do so could lead to a decentralization of the Canadian federation. Each province would be eager to claim jurisdictional authority over a foreign corporate acquisition that may not be in the best interests of their respective provinces, but could be beneficial to the country as a whole. Perhaps most importantly, there is no formal mechanism in place, outside of the Courts, to resolve this type of a dispute if and when it arises.

The Conference Board of Canada's report highlighted that the province's approach to the BHPB takeover bid would "provide an important test as to how the Province deals with other acquisitions in the future, which we see as inevitable" (2010d). Will the provincial government follow-through with its stated intention of evaluating foreign takeovers based on the "strategic" nature of the resource? Further compounding this issue is that the provincial government never clarified what exactly it meant by a "strategic resource". Is it the price of the commodity? Is it the share of global reserves located in Saskatchewan? Is it the market share of the company being acquired? It is a combination of these and other factors? We do not know.

Consider the following hypothetical scenario: BHP Billiton makes another bid PCS, this time not a hostile one, but this time the bid is so financially rich (jobs, revenue) that it provides a substantial "net-benefit" to the province. Would the provincial government support the takeover for the obvious benefits it provides its own public coffers, or would it launch a nation-wide campaign against the bid, arguing against foreign ownership of a "strategic" Canadian resource? This takeover controversy raised many questions such as how to define a "strategic resource"? And, what would constitute a legitimate justification for the federal government either to approve or to block such a bid?

This takeover bid exposed flaws in Canada's non-transparent and unaccountable foreign investment review process that have yet to be remedied. It also exposed flaws in regards to the federal government's "net benefit" analysis and the ambiguity of the factors contained therein. It also raises questions regarding approaches to federalism such as whether the federal government should defer, under certain conditions, to the province or provinces most impacted by a foreign takeover in the non-renewable resource sector. At the very least, this takeover case is a profound demonstration of the influence a provincial Premier can have on the federal government.

Undoubtedly, this takeover was also a test for the federal government. Given the provincial government's argument that the bid failed to both provide a "net-benefit" to Saskatchewan because it did not maintain Canadian control of a "strategic resource"; in the future, will the federal government base its opposition to a proposed foreign takeover bid on a "net-benefit" analysis, or whether the resource is considered "strategic", or both? In other words, are certain resources such as Potash, "strategic resources", and therefore off-limits to foreign ownership, or is PCS simply off-limits to foreign ownership because of its market share and given its own political history as a former crown corporation of the province of Saskatchewan? The answers to these and other related questions will have massive implications for federal-provincial relations and Canada's ability to attract foreign direct investment.

Undoubtedly, this is also an example of poor government relations on the part of the acquiring company, BHP Billiton. They overlooked the importance of Potash Corporation of Saskatchewan and potash (the resource itself) to the people of Saskatchewan, particularly in terms of provincial revenues derived from the resource. They failed to appreciate the influence of a provincial Premier within the Canadian federation. They failed to appreciate the leverage the Investment Canada Act affords the federal government in a takeover proposal. They failed to appreciate that they were acquiring a former Crown with symbolic and emotional appeal to many in Saskatchewan. Therefore, had BHP Billiton made better commitments to the people and province of Saskatchewan and had their commitments been made earlier in the takeover process, they may have achieved their takeover objective. Had they engaged with Premier Wall earlier and come to the table with a better offer to compensate for the province's concerns including resource revenues and Canpotex, they could have avoided the serious mistakes that ultimately lost them their bid. Ultimately, they did not demonstrate enough of a commitment to Saskatchewan and this is an important lesson for corporations seeking to invest in Canada's non-renewable resource sector. It is also an important lesson for Canadian policy-makers and interested Canadians because it demonstrates that we can say "no" to an acquiring company if the deal does not provide a "net benefit". This takeover, therefore, raises questions regarding what factors a transparent "net-benefit" analysis should include.

3.4 Why did the Federal Government Block the Bid?

The federal government's real reasons for blocking the BHPB bid remain unclear. The federal government is not legally required to publicly disclose its detailed reasons for blocking any takeover bid. During the deliberations on BHBP takeover bid, federal Industry Minister Tony Clement said: "The facts of the matter are that 'strategic resource' is not mentioned in the Investment Canada Act. It's not a concept that has a home in the nomenclature of that particular piece of legislation" (Chase, 2010) and therefore, the public and concerned investors are to conclude that the federal government's decision was based purely on the six broad factors that make up the "net-benefit" analysis. Yet, according to *The National Post* columnist Don Martin, in Canada, "no other natural resource has ever been afforded this level of government protection from a foreign buyer…" (Martin, 2010) leaving investors to wonder why "nickel, iron ore, oil, natural gas, even beer companies are available for sale to the highest bidder anywhere in the world, but a building block for agricultural fertilizer is officially off limits to foreign buyers" (Martin, 2010).

When the takeover decision was announced, Minister Clement stated that he was unconvinced by BHP Billiton's marketing abilities and therefore blocked the bid. This is odd for two reasons. 1) Concerns regarding BHP's marketing capacity, specifically its ability to market potash outside of Canpotex (the potash cartel headquartered in Saskatchewan) were addressed by the Conference Board of Canada Report and determined to be of "minimal risk." 2) BHP Billiton is the world's largest mining company, obviously capable of marketing a plurality of mineral resources for significant profit. Minister Clement stated, "BHP Billiton is a large successful mining company. But they do not have comparable experience to PCS in the mining and marketing of potash. And therefore my concern was that a successful bid could jeopardize the benefits that Canadians derive from the industry based on those grounds" (Bouw, Kiladze, Chase, 2010). Such a statement suggests the decision to block the bid was based on Section (F) of the "net- benefit" analysis that assesses "the contribution of the investment to Canada's ability to compete in world markets." But the Minister offered no evidence, just speculation, that the takeover by the world's largest mining company would negatively impact Canada's ability to compete in world markets.

The Conference Board of Canada report had addressed the issue of marketing potash internationally and concluded, "an acquisition by BHPB would appear to be of minimal risk to the Province, even if BHPB did not wish to continue PCS's relationship with Canpotex in the long term" (2010d). Further contributing to confusion were subsequent comments made by another federal cabinet minister that are different than those made by the Minister responsible for the Act and suggest the decision to block the largest takeover bid in Canadian history was made because potash was considered a strategic resource, a term that the Minister responsible for the Act said had no "home" in the Act.

During a debate in the House of Commons, Federal Agriculture Minister Gerry Ritz suggested that the federal government's decision was based on maintaining Canada's "strategic" control of the resource. In a debate on the House floor, he stated, "When we look at a *strategic resource* like potash – which is the basis for fertilizers and so on around the world – we do a tremendous job of supplying both potash and foodstuffs, in a lot of cases to the same countries, for example, China, India, Korea" (Ritz, 2010). Furthermore, he added, "It gives us a power and a *strategic position* in the global food supply to be a major supplier…for it to be able to go to the Indias or Chinas of the world and say that it now controls their fertilizer too, I think that would have had a very detrimental affect" (Ritz, 2010.) This explanation appears to contradict the one given earlier by Minister Clement that doubted BHP Billiton's ability to market potash and stated the "strategic" nature of the resource was irrelevant to the analysis of the takeover.

Therefore, given the lack of a clear and thorough explanation for the federal government's decision to block the bid—one that would identify which factors contained within the "net-benefit" analysis the decision was predicated--a number of important questions remain about the federal government's decision and the precedent it sets for both foreign takeovers and federal-provincial relations in the future. Should the term "strategic resource" become part of a modernized "net benefit analysis? Should the federal government defer to provincial governments most affected by a proposed acquisition in the non-renewable resource sector? Should the federal government modernize its foreign investment review process to include a triple bottom line analysis to more accurately provide a net benefit to Canadians? Should the federal government officially publish its reasoning so that the public and businesses alike can access and understand the rationale for or against a takeover?

Currently, interested parties and the public must rely on often-contradictory statements from Ministers that may or may not represent the official policy of the Government of Canada. Currently, the Minister responsible for the Investment Canada Act is not required to provide any reason to the public when a bid is either approved or blocked. The Minister is only required to submit a notification to the applicant if the bid is being blocked. This creates confusion, uncertainty, and does not meet modern standards of transparency and accountability.

3.5 What Are the Implications of the Federal Government's Decision?

The federal-government's decision not to approve the BHPB hostile takeover of PCS leaves us with an important question regarding the criteria that will be applied in future cases when international investors attempt to gain control of natural resource companies with natural resource extraction rights in Canada. Will the approval of future foreign takeovers be based on a "net-benefit" analysis, or maintaining Canadian control of a "strategic resource", or both? If the answer is both, the federal government would have to define what a strategic resource is or is not and then clarify what exact standards are required to pass a "net-benefit" analysis that considers the "strategic" nature of a resource. To do otherwise would continue to confuse foreign investors, if not outright discourage them from investing at all if there remains no clear process for future bids. As one corporate spokesperson put it, "the more clarity we have, the easier it is to sell Canada as an attractive foreign investment destination" (Johnston, 2010).

The federal government struggled to articulate the rationale for its decision to block the BHPB bid, declaring it did not provide a "net-benefit" to Canada, but without providing any objective evidence of this. Thus, it appears that the federal government succumbed to Saskatchewan's compelling arguments and effective political tactics in its opposition to the bid. By succumbing to Saskatchewan's political pressure, the federal government has set a new precedent that could allow other provinces to claim what resources are "strategic" and to define what is or is not of a "net-benefit" based solely on their province's best interests, but not the country as a whole.

In its own defense, after it withdrew its application, BHP Billiton highlighted some of the undertakings it had promised the federal government. Clearly, BHP Billiton was frustrated that their company had been blocked from acquiring PCS due to political considerations rather than commercial considerations and wanted to prove to Canadians that their offer had been a good one. ""The Australian company laid out what it called "unparalleled" promises it made on jobs and investment, including commitments to spend $370-million on infrastructure in two provinces, to give five-year employment guarantees at Potash Corp.'s Canadian mines and to move 200 jobs from outside the country to Saskatchewan and Vancouver. Those promises "would have resulted in a significant net benefit to Canada, Saskatchewan and New Brunswick," BHP said in a statement"" (2017b).

3.6 <u>The Issue of Strategic Resources</u>

One of the most significant policy issues that came to the fore during the BHP Billiton hostile takeover bid for PCS was Saskatchewan Premier Brad Wall's opposition to the bid based on the argument that potash is a "strategic resource." The decision by the federal government to block the takeover bid was arguably based on this criteria even though the term "strategic resource" is not found in the Investment Canada Act. "What's most concerning about this precedent, however, is how Wall turned the ICA on its head, introducing a new lexicon into the legislative test. The act is supposed to be about determining the net-benefits of a foreign takeover. That's not how Wall pleaded his case. Rather, he introduced the concept of "strategic resource" and pleaded for the federal government to protect Potash on that basis" (Middlemiss, 2017). The invocation of the term "strategic resource" was a very effective political manoeuvre by Premier Wall and his argument in favour of such a term was well articulated. However, the rationale for any resource to be declared "strategic" is worthy of further consideration by policy-makers. Arguably, all non-renewable resources are strategic because they are depleting assets. And why should potash, of all Canadian resources, be deemed strategic? And to what affect?

During the BHP-PCS takeover, the Province of Saskatchewan created its own version of the federal government's "net-benefit" analysis in order to determine whether the takeover should be approved or not. The "strategic" element of the resource was one of three provincial factors. However, since the Investment Canada Act contained no mention of this criteria, this put Saskatchewan's net-benefit analysis at odds with that of the federal government. As Premier Wall stated, "We have applied this net-benefit analysis in three different areas. Number one is jobs. Number two is revenue, your revenue, the rent you should be getting for the resource that you own. And number three is this concept of what about our *strategic interests* in the world going forward." (Wall, 2010).

Premier Wall declared potash a "strategic resource" on numerous occasions during the takeover controversy. When elaborating on the province's own "net-benefit" analysis during a speech to the SK Chamber of Commerce, the Premier spoke at length about potash being a "strategic resource." "We know then that this amazing nutrient we have in such great abundance in the province, this potash, is going to be in greater supply. It is a *strategic resource*. And we should act like it. The country should act like it" (Wall, 2010).

Saskatchewan's net-benefit analysis, therefore, contained three equivalent criteria: 1) jobs, 2) revenue, and 3) strategic interests. Of those three criteria, only jobs was a factor that the federal government considers in its own net-benefit analysis, the only analysis that determines the outcome of a takeover bid. It is worth considering the impact of any takeover on provincial revenue, but the federal government does not use this factor in its current evaluation process of foreign takeovers.

Premier Wall elaborated on his government's analysis of the takeover when stating during the takeover controversy, "We believe there is a risk for a net loss to jobs in the country. We believe there is a significant risk to net loss to revenue for the Governments of Saskatchewan and Canada, revenue that in our province that would require deficits, or tax increases, or program cuts, or some combination of those things. And our assessment also tells us that the takeover will result in a net loss of our *strategic influence* around the world, at a time when the influence of our province, and I think our country, should be on ascendancy" (Wall, 2010). Although the impact on jobs and provincial royalties can be objectively determined in a takeover bid, the strategic element of a resource is a much more controversial factor, one which had never before been proposed by such a high profile politician in Canada. Interestingly, the same issue arose again just a few years later during the CNOOC Ltd. takeover of Nexen Inc. when the federal government declared the oil sector effectively off-limits to future SOE investment. But, only during the BHP Billiton attempted takeover of PCS was the word "strategic resource" employed as a key argument against the takeover.

Premier Wall made the case for the strategic element of Potash by stating that the resource would become increasingly in demand worldwide as arable land decreases due to urban sprawl, requiring greater agricultural intensity. Premier Wall also stated that protein intensity in diets is increasing and that this will require countries to seek out potash reserves. Although he did argue that potash is a strategic resource, Premier Wall was not suggesting that all potash investment in the province should be off-limits to foreign ownership. The Government of Saskatchewan allows potash corporations, some foreign-owned, including Mosaic, K+S Potash, and BHP Billiton to operate in the province. And since the blocked BHP Billiton hostile takeover bid, a Chinese SOE, Yancoal, has been granted permission to begin the construction of a new mine in the province. Therefore, while the resource may indeed be strategic it remains open to foreign investment and foreign acquisition, leaving one to assume that what the Premier meant was *PCS is a strategic company* because of its sizeable market share (30% of global reserves) and political history (former SK Crown, privatized in the 1980s) and thus PCS, not potash, warrants protection from being acquired by a larger and more distantly headquartered multinational corporation.

During the BHP Billiton takeover bid for PCS, Premier Wall stated, “This takeover involves 25-30% of the known reserves in the world's potash. This is different. This is not like any other takeover that we have contemplated in the country” (Wall, 2010). This statement more accurately reflects the issue. The issue is not whether potash, because it is a “strategic resource” is off-limits to foreign ownership, as that was not, nor is the case. Keep in mind that during the takeover, PCS was only 49% Canadian owned and was arguably an American controlled company. Thus, the issue was the degree of control of a strategic market, in this case, the potash market, by a Canadian-headquartered company or “Canadian business”. The market share, or market power of a Canadian-headquartered company was at stake. If the takeover were to occur, this market share would be controlled by BHP Billiton, an Australian-owned and headquartered mining giant, effectively turning PCS into a branch office of their operations with negative provincial revenue implications, estimated at $200 million per year.

What Premier Wall was stating is that the potash market is strategic and that a substantial Canadian-owned (albeit privately-owned and only by 49% Canadian shareholders) presence in this “strategic market”, of which Canada owns more than half of the world’s reserves, must be protected. Therefore, we are to infer that the portion of the world’s potash reserves that Canada should protect from foreign acquisition, according to Premier Wall, is approximately no less than 25-30% of global reserves since that is the portion that BHP Billiton would have acquired, but did not, in large part because of Premier Wall’s public protest. Therefore, Canadians are to infer that roughly 25-30% of the global reserves of a strategic resource should be protected from foreign ownership.

Premier Wall also questioned the strategic value of a takeover that would result in the loss of a corporation (PCS) whose main priority was potash and potash related industries. “Are our strategic interests in the province likely better served by a company who’s vested in potash, that that's their really number one priority? That's their most important profit centre. Or are we better served by a company, a good company, but one that has 100 different mines in 25 countries? A company for whom this massive proposition still only accounts for about 20-25% of their business" (Wall, 2010). This statement implies that the Premier was not convinced that BHP's operations structure and corporate interests aligned with Saskatchewan's strategic priorities for the potash industry. In other words, the potash industry was vital to Saskatchewan, was it as vital to BHP Billiton? The Premier's comments indicate that he did not believe it was.

The issue of whether Saskatchewan's interests would be better served by a foreign-owned multinational corporation or a Saskatchewan-based corporation appears to have been answered by BHP Billiton in 2008 when Don Argus, chairman of BHP, stated that "Canada's policies are a worst-case scenario…Canada has lost more head offices than any other country...Canada has already been reduced to an industry 'branch office' and is largely irrelevant on the global mining stage" (Reguly, 2011). These comments by the chairman appear to prove the Premier's argument, that BHP Billiton saw Saskatchewan as nothing more than a "branch office" operation. And it was true that BHP Billiton was only going to run their potash headquarters out of Saskatchewan. i.e. a branch office. Whereas, arguably, the global headquarters of PCS were based in the province, and PCS publically committed to maintaining that head office in the province during the proposed takeover in their effective and timely "Pledge to Saskatchewan" in which they outlined numerous commitments to the province.

It is possible, given the substantial reserves under its control that PCS is a strategic company, but Premier Wall never made the argument that PCS was a strategic company. Rather he made a strong case for potash being a Canadian "strategic resource", effectively employing a nationalistic argument in order to block this takeover. But what, specifically, makes potash a strategic resource, as opposed to any other Canadian "resource" commodity, including oil, gold, diamonds, aluminum, or nickel, and to what affect?

Saskatchewan, and therefore Canada, has the world's largest known reserves of potash and is the world's largest producer of potash. Premier Wall used these facts to contend that potash should be labelled as a "strategic" resource with the affect that PCS should be protected from the hostile takeover bid of BHP Billiton. However, in addition to significant potash reserves and production capacity, Canada also has the world's 3rd largest share of Uranium reserves, and is the world's second largest producer of that resource. Canada has the 3rd largest oil reserves in the world and Canada is the 5th largest producer of oil in the world. Canada is the 2nd largest producer of Nickel and has the 11th largest share of global reserves. Canada is the 5th largest producer of Gold. Canada is the 5th largest producer of diamonds and has the 6th largest reserves. Canada is the 3rd largest producer of aluminum and has the 3rd largest reserves. Lastly, Canada is the 6th largest producer of wheat. The point is that Canada ranks in the top 10 for global reserves and production in nearly all these "resources", and therefore any of these resources could be considered "strategic" from that perspective.

But proven reserves and production capacity cannot be the only measure of whether a resource is "strategic". The price of the resource, which, amongst other critical factors, determines the amount of revenue that goes to provincial government coffers, must also be a factor in whether a resource is strategic. For, if a resource was "worthless", it would not be strategic. The "worth" of the resource to the public is determined by the provincial royalty structure. Saskatchewan's royalty scheme, which is often criticized for its complexity, consists of, amongst other taxes, a profit tax from which is derived the majority of provincial revenue. "The profit tax generates most of the province's potash revenue. So when there is a spike in prices and profits shoot up, the province reaps some of that windfall. A rise or drop in sales can also affect the royalties, but not as much as a change in prices" (Blackwell, 2010). Although Saskatchewan "…averages between $200-million to $500-million, it's not always in that range. With a spike in commodity prices in 2007 and 2008, the government raked in $1.36-billion in its 2008-2009 fiscal year" (Blackwell, 2010). Such a revenue haul is in sharp contrast to the $262 million the province received just two years later in 2010-2011 or even the $556 million it received in 2015-16. Furthermore, Potash Corporation's profit margin declined 74% this fiscal year 2016/17, meaning Saskatchewan will reap less than the 279 million it forecast earlier this year (MacPherson, 2017).

Perhaps most interesting is that oil revenue is generally much higher than potash revenue in Saskatchewan, yet potash was declared a "strategic" resource, and oil is not yet declared as such by the province of Saskatchewan. In 2010, the year of the BHP Billiton hostile takeover bid of PCS, oil revenue was nearly 1.3 billion, while potash revenue was less than one-fifth of that at $262 million. Yet, Saskatchewan has never declared oil a "strategic" resource. Between 2006-07 and 2015-16 fiscal years, oil contributed on average $1.4 billion annually in provincial government revenue. Whereas, during the same time period, potash contributed on average $423 million in provincial revenue. Therefore, oil is a far more "valuable" than potash for

Saskatchewan because it provides far more public revenue and yet oil is not deemed strategic.

Is a strategic resource one that provides stable returns for the people of the province, to whom it belongs, or does the price of a strategic resource fluctuate unpredictably and uncontrollably causing substantial financial problems? Just one year prior to the BHP Billiton takeover bid for PCS, potash revenues were $2.1 billion less than budgeted. That fiscal year, 2009-10, the Province of Saskatchewan reported a negative potash revenue of -183 million. They had forecast 1.9 billion in revenue, significantly higher than historical averages. For a province with an annual budget of nearly 14 billion, a swing of 1.9 billion in the wrong direction is a critical hit. The point is that a resource with such a volatile price, resulting in volatile government revenues and inaccurate budgeting, is not an ideal choice for a “strategic” anything. Either that, or Saskatchewan needs to adjust its royalty structure to accommodate such volatile revenue streams. One would think that since potash is a “strategic” resource, the royalty structure of the province would aim to protect Saskatchewan strategic interests, one of those surely being consistent and stable government finances.

Premier Wall argued during the takeover bid for PCS that the high demand for potash and the high volume of reserves makes it a strategic resource. Both demand and volume contribute to price, and when Premier Wall opposed the takeover of PCS, potash was selling for over $500 per tonne, but just two years earlier had been selling for upwards of $1,000 per tonne. In 2016, six years after the takeover, the price of potash is around $150 per tonne. Therefore, global demand for potash has clearly decreased significantly since the takeover was blocked. Furthermore, PCS was worth approximately twice as much in 2010 as it is in 2016. In 2010, BHP Billiton was offering $38.6 billion for the purchase of PCS, and the company is now worth approximately $19.6 billion in 2016 at the time of its proposed merger with Agrium in fall 2016. Therefore, global potash prices have plummeted, PCS shares have plummeted, and the company’s net-worth has plummeted since the takeover was blocked in 2010. This does not mean that blocking the takeover bid is to blame for the drop in commodity prices or the company’s market capitalization. Rather, the point is that whether a resource is deemed “strategic” or not by any government, its value or worth fluctuates due to often distant and uncontrollable factors.

For instance, the breakup of a major Russian-Belarusian potash cartel in 2013, the Eastern-European equivalent to Canpotex, caused global potash prices to plummet 25%, nearly overnight. The Belarusian Potash Company cartel had controlled upwards of 40% of the market until the

Russian partner (Uralkali) of the cartel abandoned the enterprise. Much like Canpotex (and Canpotex was cited regularly by Premier Wall as a reason for blocking the takeover of PCS), this cartel helped limit supply and control prices. As National Post columnist Andrew Coyne noted, “The collapse of the cartel came as a shock to markets, but it shouldn’t have: Uralkali’s strategic shift in favour of volume over price was much the same as what BHP had signaled three years before. It was no more than an overdue acknowledgment that potash was overpriced — or, to put it another way, that cartels are unsustainable in the long run. For in the gap between the cartel price and the market price lies opportunity, and a constant temptation for one or another of the cartel partners to break ranks” (Coyne, 2013).

Evidently, whether or not Canada declares a resource, such as potash, “strategic”, market conditions will always define its worth and its worth, in turn, determines its value, which must be a determinant of whether it is strategic or not. As the worth of all resources fluctuates significantly, most often because of unpredictable market conditions, the “strategic” element of the resource must fluctuate also. Therefore, when the price inevitably drops, as has been the case most recently with potash and oil, the resource becomes less “strategic”. The only constant in any of this is that significant and often uncontrollable market-driven price fluctuations are inevitable in the non-renewable resource sector, rendering claims of a single “strategic resource” precarious and fleeting, although politically advantageous in the short-term.

John Manley, a former Liberal Party MP and Minister of Industry, stated that Premier Wall’s stance was a political decision. “The Premier’s ‘strategic resource’ rationale is a political calculation — one that he is entitled to make if he feels he can justify it to his citizens. But the *ICA* exists to ensure that Canadians benefit from foreign investment, not to protect *resource companies* designated as ‘strategic’ at the 11th hour by provincial governments” (Assaf and McGillis, 2013). Assaf and McGillis in their study of the Investment Canada Act agree with Manley and contend that, “The identification of particular “strategic assets” does not…ensure that an investment will be of any greater net benefit to Canada than that which the *ICA* already effectively requires. It is a loaded term, and easily politicized and misused by any stakeholder, as we have seen.” (Assaf and McGillis, 2013). Assaf and McGillis also make the reasonable suggestion that given recent controversy around this term “strategic resource”, Canada needs to clearly state that “strategic asset” has no part in the ICA review. “Given the salience of the term “strategic asset” and its increasing prevalence in political debate and media commentary, the federal government should reiterate that no review category of transactions exists for such purposes...” (Assaf and McGillis).

Therefore, while it may be politically popular or advantageous to define a certain non-renewable resource as “strategic”, all non-renewable resources should be considered “strategic” because they are, by definition, limited in supply. That is, in part, why their acquisition of control is subjected to a thorough foreign investment review based on a defined set of criteria that determine whether there is a benefit to Canada or not. It is these criteria that will enable Canadians to maximize the benefit of a foreign takeover, not whether the resource is labeled strategic. Furthermore, declaring a certain resource as strategic, without defining the affect this should have on future acquisitions, only leads to investment confusion.

The issues associated with “strategic resource control” discussed in this section were of paramount concern to policy-makers once again during the CNOOC takeover of Nexen, just two years later. In the CNOOC-Nexen case, however, the issue of strategic resource control was applied to oil, specifically protecting Canadian oil reserves from being acquired by foreign SOEs.

3.7 <u>Conclusion</u>

The province of Saskatchewan successfully influenced the federal government’s decision to block BHPB’s hostile takeover bid of PCS, in part, because of its articulation and invocation of the term “strategic resource” as a criterion to be included in the calculation of a ‘net-benefit’ to Canada as they apply to foreign takeovers in the non-renewable resource sector. Additionally, Saskatchewan’s Premier Brad Wall used many effective tactics in order to influence the outcome of the federal government’s decision. The Conference Board of Canada report his government commissioned, his argument that BHP Billiton sought to turn Saskatchewan’s potash industry into a “branch office”, his threat of a lawsuit against the federal government, and his effective use of executive federalism were paramount to the outcome of this takeover bid.

The decision to block BHPB’s hostile takeover bid of PCS has created a serious policy challenge for Canada. The reason for the federal government’s decision to block this bid remains unclear, contradictory, and unconvincing. Only one out of 1,600 other takeovers had ever been blocked. Therefore, what made this takeover so unique that it required government protection? A reliance on the ‘strategic resource’ criterion was articulated both by the Premier of Saskatchewan and a federal Cabinet Minister in defense of blocking the takeover bid. Indeed, Saskatchewan Premier Brad Wall's successful campaign to block the hostile takeover bid was based in large part on the issue of "strategic resource" control, and the importance of this undefined criterion in the calculation of a "net-benefit" to Canada. Evidently, the federal government also relied on the undefined criterion in its calculations of 'net benefit'. This is evident in comments made after the decision not to allow the takeover was announced. At that time, federal Agriculture Minister, Gerry Ritz, also alluded to the issue of "strategic resource" control as being a factor in the government's decision. Thus, although the definition of a "strategic resource" was and remains vague, the extent to which the federal government relied on that criterion in its calculation of a 'net benefit', and the extent to which it will and should use it in future calculations of a "net-benefit" to Canada remains unclear. The lack of clarity surrounding this criterion and Canada's entire foreign investment review process could have significant implications for the Canadian public, corporate interests (both foreign and domestic) and serious consequences for federal-provincial relations pertaining to resource management within the Canadian federation. Just two years later, another takeover bid, and this time by a Chinese State-Owned Enterprise (SOE), would bring these and other questions back to the fore.

CHAPTER 4: THE CNOOC TAKEOVER BID OF NEXEN

4.1 Introduction:

On December 12th, 2012, Prime Minister Stephen Harper announced that the Government of Canada had approved CNOOC’s $15.1 billion takeover bid for Nexen Inc., representing the largest foreign acquisition by a Chinese State-Owned Enterprise (SOE) in world history. Although the controversial takeover bid was approved, the federal government simultaneously announced new guidelines for takeovers by foreign SOEs. "When we say Canada is open for business, we do not mean that Canada is for sale to foreign governments," Prime Minister Harper said (Chase and McCarthy, 2012). Clearly, the new guidelines were designed to limit the sale of Canadian-headquartered oil companies to foreign State-Owned Enterprises (SOEs) going forward. The official opposition was quick to criticize the decision, "While Conservatives admit that under the new rules this transaction is not a net benefit to Canadians, they have approved it anyway," NDP Critic Peter Julian said in a statement (Isfeld, 2012).

According to Prime Minister Stephen Harper, “The larger purposes of state-owned enterprises may go well beyond the commercial objectives of privately owned companies" (Kennedy, 2012). Evidently, this assumption was a fundamental component of the government’s decision to limit SOE investment. “…given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister of Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be a net benefit to Canada on an *exceptional basis only*” (2012b). This new policy is intentionally ambiguous and suits the short-term political interests of decision-makers, but does not provide sufficient clarity for investors and the attentive Canadian public. What are the “exceptional” factors under which a foreign SOE will be allowed to invest? This policy also discriminates against SOE investment, the largest source of ownership in the energy sector.

While approving the takeover, Prime Minister Harper stated that Canada would gradually increase the threshold for review of foreign takeovers by *private enterprises* under the *Investment Canada Act*, but not SOEs, thus having the affect of fewer reviews for private enterprises. The government committed itself to gradually raising the value of bids that require approval so that in four years from adoption (2015) only those worth more than $1 billion would require approval. The threshold for review would be indexed annually to reflect changes in Canada’s nominal GDP. However, the threshold for foreign SOEs would remain at $330 million while also indexed annually to Canada's nominal GDP. Clearly, the effect of this major policy change would be to undertake fewer takeover reviews of privately owned foreign corporations by raising the nominal threshold for review, while imposing new guidelines on SOEs and thereby ensuring greater restrictions on SOE investment relative to other forms of investment.

The CNOOC takeover of Nexen is seen by many as the first step in a long march towards greater Chinese control of Canadian resources. However, Chinese FDI accounted for a mere 3.4 per cent of Canada's total FDI stock in 2014, meaning a) Canada could benefit from more investment from one of the world's largest economies and b) fears about China "buying up" Canada are not factually based. Fears of Chinese SOE investment are also not based on behavior, but rather, small government ideology and preconceived notions about the People's Republic of China.

This takeover bid raises not only the policy challenges associated with SOE investment but also demonstrates, once again, the influence of a provincial Premier in the foreign investment review process, in this case, Alberta's Premier Alison Redford. This takeover, more than any other, also demonstrates the need for undertakings to be made public at the time of acquisition and for the Minister's decision of approval to be made public as well so that Canadians can hold decision-makers and the acquiring corporation to account. In this case, it appears that many of the commitments made by the acquiring corporation has not been fulfilled.

4.2 Historical and Jurisdictional Context

Alberta's oil industry has been one of the most controversial industries in Canada since the first oil well was discovered in the province in the early 1900s. Alberta's government has had, at times, a contentious relationship with the federal government concerning the control of the resource. The National Energy Program (NEP), Canada's most infamous example of federal intrusion in an area of provincial jurisdiction, is commonly regarded as a cause of "western alienation"—a sentiment amongst western Canadians that the federal government's policies were contrary to their economic and political interests. The implementation of the NEP and the creation of Petro-Canada, a Crown corporation, created lingering animosity to the nationalization of the oil industry in Alberta.

The decision to limit the investment of SOEs in the oil industry by the Harper government can be traced back to the NEP and the creation of Petro-Canada, a Canadian Crown corporation or (SOE) oil company. Arguably, even the formation of the modern Conservative Party, led by Prime Minister Harper, himself an Albertan, was created as a result of the NEP and the sentiments of western alienation. Its predecessor, the Reform Party which lived by the infamous slogan “the west wants in”, then became the Canadian Alliance Party, which then merged with the Progressive Conservative Party to form the modern Conservative Party of Canada. “To be blunt, Canadians have not spent years reducing the ownership of sectors of the economy by our own governments, only to see them bought and controlled by foreign governments instead,” said Prime Minister Harper when announcing the new guidelines for SOEs (Cattaneo, 2017a). The Progressive Conservative Party, a predecessor of the Conservative Party, had privatized Petro-Canada in 1990, and thus, Prime Minister Harper’s comments on SOEs was not unusual or unexpected given the historical roots of his political party.

The Prime Minister’s reference to the sale of Crown corporations was particularly relevant given that Nexen Inc. originated as Canadian Occidental Petroleum Ltd. (CanOxy) in 1969. In the early the 1990s, CanOxy acquired the assets of recently privatized Wascana Energy Inc, formerly Saskatchewan Oil & Gas Corporation (SaskOil), a Crown corporation of the province of Saskatchewan and the first state-owned oil and gas company in North America. SaskOil was created by the NDP government of Saskatchewan Premier Alan Blakeney in 1973, and was privatized by the Progressive Conservative government led by Premier Grant Devine in 1986. Therefore, by approving the takeover of Nexen by CNOOC, Prime Minister Harper enabled what was a Saskatchewan Crown corporation (SaskOil, later Nexen) to be sold to a Chinese SOE.

Given the political origins and small-government ideology of the party he lead at the time, it was not surprising that the federal Conservative government under the leadership of Prime Minister Harper would seek to reduce the role of government ownership in the non-renewable sector and do so by limiting SOE investment going forward. At the same time, however, the federal government approved the takeover bid, in part, because Alberta Premier Alison Redford supported the takeover. Furthermore, the Prime Minister wanted to maintain positive relations with the People’s Republic of China, one of the world’s largest economies and potential sources of FDI. His government, therefore, approved the takeover and simultaneously implemented new restrictions and thresholds for SOE investment, appeasing his party that had a combination of anti-communist tendencies and a profound skepticism of the state's influence in the economy coupled with a respect for a shareholder's right to profit and the value of FDI.

*4.3 **Role of the Provinces***

Alberta Premier, Alison Redford, came out in favour of the CNOOC takeover bid on October 1st, 2012. "At the end of the day, our view is that if this is in Alberta's interest, it should go ahead. And we think there's a lot of benefit for Alberta and Canada in this deal" (Cryderman, 2012). She further added, "We welcome foreign investment. Our energy industry would not have grown without foreign investment and technological development" (Cryderman, 2012).

This response differed significantly from Saskatchewan Premier Brad Wall's in reaction to BHPB's hostile takeover of PCS. Premier Redford saw this type of foreign investment as positive for the province's economy and interestingly did not make SOEs an issue. "Whether an investor is coming from another part of Canada, or another part of the world … they are simply buying leases to extract our resources on our terms," said Redford (Wheeler, 2012).

Premier Redford had visited China with Canadian business leaders, and 9 of Canada's 13 Premiers in September 2012. During this visit, Premier Redford attended a 400 guest dinner with CNOOC executives and Chinese government officials at which China's Minister of Commerce, Chen Deming, made the case for CNOOC's takeover bid as a pathway to further economic ties based on "market rules." Mr. Chen also said the two countries "have a huge amount of potential to be tapped" (Argitis, Mayeda, and News, 2012). CNOOC's CEO Li Fanrong made the case for the takeover bid specifically. "Our investment … is good for Alberta, good for Calgary, good for Canada as a whole," he said (Argitis, Mayeda, and News, 2012).

Less than a month later, Premier Redford reportedly asked Industry Minister Christian Paradis for certain conditions to be met in the takeover bid. "Redford wants guarantees that at least 50% of Nexen's board and management positions will be held by Canadians" (Argitis, Mayeda, and News, 2012). Furthermore Redford's government reportedly requested that CNOOC Ltd. "maintain workforce levels for at least five years, to strengthen commitments to keep planned capital spending and to clarify plans for research and development." (Argitis, Mayeda, and News, 2012). These requests were made by Premier Redford in an attempt to 1) encourage the federal government to approve the bid because of the benefits derived from foreign direct investment while 2) ensuring maximum benefits for Albertans. These specific requests concerning management makeup were made in an attempt to dissuade public concerns regarding the takeover of the oil sands by foreign SOEs.

Saskatchewan represented the other province most impacted by this takeover. Saskatchewan Premier Brad Wall, having ensured the acquisition of PCS by BHP Billiton failed two years earlier, stated that there were major differences between the two takeover bids. “Potash Corp was a dominant player in the world potash supply whereas Nexen represents a fraction of what’s a pretty important resource, but not nearly in a quantity to be strategic” (2012c). Premier Wall also raised concerns about SOE investment. In general, the CNOOC-Nexen takeover generated far less controversy than the BHP Billiton-PCS attempted takeover because the latter was a hostile takeover and was opposed by the province of Saskatchewan. The CNOOC-Nexen takeover was supported by both Nexen shareholders and the Alberta government, as long as certain conditions were met, resulting in less federal-provincial conflict and less of a need for Premier Redford to rally the support of other Premiers, as Premier Wall had done during the BHP Billiton-PCS takeover bid.

4.4 Why did the Federal Government Approve the Bid?

With the tacit support of Premier Redford and the Alberta government, there was far less political pressure on the federal government to block the bid then there was to approve it. Canada’s relationship with China was also a significant factor in the approval of this takeover bid, as was maintaining a free-market economy and attracting foreign investment to Canada. Yet, these factors had to be balanced with the public’s skepticism and the government’s skepticism of foreign takeovers by SOEs, particularly those from China. Therefore, the federal government did approve the takeover bid but with new guidelines for SOEs seeking to invest in the oil patch. In addition, in order to dissuade foreign investor concerns, Canada raised the threshold for the review of foreign direct investment so as to conduct fewer reviews and thereby encourage private foreign capital.

While announcing the approval of the CNOOC/Nexen takeover bid, Prime Minister Stephen Harper stated, "The government's concern and discomfort for some time is that, very quickly, a series of large-scale controlling transactions by foreign state-owned companies could rapidly transform this industry from one that is essentially a free-market industry to one that is effectively under the control of a foreign government. And that is obviously not something that we think would be desirable” (Payton, 2012). Clearly, the Harper government was suspicious of SOEs and their role in Canada’s economy and this was a major factor in the government’s decision to approve the bid with caution. As a result of this, the federal government created more cumbersome criteria for SOEs in order for such foreign investment in the oil sands to be approved.

The new guidelines announced for SOEs give the Minister responsible for the Investment Canada Act, considerable authority to block a foreign takeover based on “the degree of control or influence an SOE would likely exert on the Canadian business that is being acquired; the degree of control or influence an SOE would likely exert on the industry in which the Canadian business operates; and, the extent to which a foreign state is likely to exercise control or influence over the SOE acquiring the Canadian business” (2012b). These new guidelines will therefore not exclude foreign direct investment in Canada from SOEs, but would make the approval of this type of investment much more difficult.

The decision to limit SOE influence in Canada’s oil patch was rationalized based on the desire for free market principles to dominate the industry. “While the vast majority of global energy deposits are state-controlled, Canada's oil sands are primarily owned by innovative private sector businesses. If the oil sands are to continue to develop to the benefit of all Canadians, the role of private sector companies must be reinforced” (2012b). Clearly, the Harper government was skeptical of foreign investment from SOEs based on ideological assumptions about the role of government and suspicions about the non-commercial intentions of Chinese SOEs. Even though the vast majority of energy deposits in the world are controlled by SOEs, including many heavily invested in Canada already, Canada was effectively closing itself from that type of investment in the oil sector going forward. “Given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister of Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be net-benefit to Canada on an *exceptional basis only*” (2012b).

Perhaps most surprising is that the federal government approved the bid at all. A poll conducted by the Asia Pacific Foundation in 2010 concluded that “…fewer than one-in-five Canadians would be in favour of state-controlled companies from China and India buying a controlling stake in a major Canadian company” (2017a). This, coupled with the Conservative government’s inherent skepticism of SOEs and the People’s Republic of China, demonstrates that either a) the desire for foreign capital must have been determined to be paramount for Canada's economic viability by the government at the time or b) the Sino-Canadian relationship was determined to be at stake or C) they were swayed by Premier Redford's arguments in favour of the bid or D) the government wanted to respect a shareholders right to profit or E) all of the above.

The support of Alberta's Premier Alison Redford would have been a major factor, as would the implications for Canada's relationship with the People's Republic of China. Timing was also a likely factor, as it is plausible that the federal Conservative government could not afford to block another takeover in the non-renewable sector, having just two years earlier blocked BHP Billiton's bid for PCS, and, at the same time, remain objectively "open for business." Another possible factor is that unlike the BHP Billiton takeover attempt of PCS, during which the Conservative government of Prime Minister Stephen Harper had a minority government, this time, they had a majority government and could afford, politically speaking, to approve a controversial takeover of a Canadian-business by a Chinese SOE.

4.5 <u>**The Issue of State-Owned Enterprises (SOEs)**</u>

The successful CNOOC bid for Nexen in 2012 brought issues concerning state-owned enterprises to the fore of policy-makers. Although the federal government did approve the takeover bid, it simultaneously imposed additional restrictions and a lower threshold for review on SOE investment in all sectors that it did not impose on private enterprise and declared that, "…given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister of Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be net benefit to Canada on an *exceptional basis only*" (Government of Canada, 2012b). But, what are the inherent risks associated with SOEs? What are the exceptional circumstances for which a takeover by a foreign SOE will be approved? Is Canada now closed to foreign-investment in the oil sector from SOEs? If so, is such a policy wise? Do all SOEs pose inherent risks or is this policy a veiled attempt to discriminate against Chinese SOEs because of inherent ideological biases? These questions are "…especially pertinent to a resource-rich country like Canada because so much of China's overseas FDI is in resources" (Grant, 2012). SOEs also control by far the majority of resource reserves worldwide and are therefore a large potential source of FDI in the energy sector; meaning Canadian policy-makers should not dissuade such a large source of foreign capital but should instead shape it in accordance with Canadian interests.

This section will explore the reasons for the federal government's decision to limit, and in some cases, deny future SOE investment. It will conclude that such a policy is disadvantageous to Canadian political and economic interests. It will explain that such a policy stems from a political bias against the People's Republic of China, and SOEs, both foreign and domestic. This section will conclude that fears of Chinese SOEs, due to their perceived non-commercial interests, are overblown and are inconsistent with behavior. Canada must therefore stray from its current approach of discriminating against SOE investment in the oil sands. Instead, Canada should reform, modernize, and strengthen its current foreign investment legislation in order to protect its multitude of security, economic, environmental, and social interests without discriminating against Chinese SOEs. This is the pathway towards long-term peace and prosperity for both countries.

When the Conservative Party led by Prime Minister Stephen Harper was elected in 2006 their "…election platform did not mention China, nor did the Conservatives include China on their list of Canada's democratic and economic partners in Asia with whom free trade agreements should be negotiated" (Evans, 2014). Improving the relationship with China was, therefore, not an initial priority for the federal Conservative government. Their criticism of the previous Liberal government's foreign policy in their platform that year was clearly directed at China. According to their platform, Liberal policies had "…compromised democratic principles to appease dictators, sometimes for the sake of narrow business interests" (Evans, 2014). This statement, "…made clear that China and the China policy of the past were in the cross-hairs of an approach that would emphasize the core Canadian values of freedom, democracy, human rights, the rule of law, free markets, and free trade" (Evans, 2014). The Conservative government's foreign policy was in part a result of their inherent anti-communist and anti-SOE political biases. "The Conservatives brought with them strong, anti-communist impulses…a values-based world view that drew a sharp distinction between friends and enemies based on their political systems, and a libertarian-infused philosophy of governance that envisioned a "small government" role focused on facilitating transactions rather than building relationships." (Evans, 2014). It was these beliefs that put them at odds with Chinese state-capitalism and SOEs broadly.

These opinions of China and SOEs are hardly unique to the Conservative Party of Canada.

For instance, "…almost three times as many Canadians have a cold or unfavourable view of China as have a warm or favourable one. China is consistently seen by a significant number of Canadians as corrupt, authoritarian, and threatening" (Evans, 2013). Most interestingly, given the implications for the CNOOC-Nexen takeover and future acquisitions, "…fewer than one in five Canadians are in favour of allowing a state-controlled company from China to buy a controlling stake in a major Canadian company" (Asia Pacific Foundation of Canada, 2017a).

The Conservative government was therefore in a difficult political position and faced two competing political realities. Undoubtedly aware of the opinions of Canadians on SOEs and the People's Republic of China, the Conservatives were simultaneously governing a country with resource-extraction industries heavily dependent on foreign capital and investment. Particularly relevant was the Conservative Government's constant and determined support for the oil sands both domestically and internationally. The origin of their political movement was forged by the Alberta oil sands and that industry's freedom from state-control or interference. They would therefore have to strike a balance between these competing political realities by allowing foreign capital without sacrificing their anti-communist and anti-SOE principles.

Thusly, they approved the CNOOC takeover of Nexen, but simultaneously imposed new restrictions on SOEs that appear to prevent any future SOE investment in Canada's largest energy industry, the oil sands. The restrictions appeased their small-government base and ideological bias against SOEs, the approval itself appeased their base whose livelihoods rely upon the influx of foreign capital into the oil sands and that industry's continued growth. It was a wise short-term political decision, but not, ultimately, in the best long-term interests of the Canadian economy or the Sino-Canadian relationship.

SOEs own the vast majority of global energy reserves. As some analysts have stated in regards to the CNOOC takeover of Nexen, "this deal may be the beginning of a wave of Chinese resource acquisitions in Canada" (Hodgson and Bloom, 2012), and it was specifically for this reason that the Conservative Government subsequently declared that future SOE takeovers in the oil sector would be approved on an *"…exceptional basis only."* But rather than dissuade such investment, Canada should strive to shape it in accordance with its own values and interests. This can be done through a modernized foreign investment review process that would maximize the benefit to Canadians based on a triple bottom line analysis, including a thorough national security review. China will continue to seek out foreign investment opportunities and Canada cannot afford to dissuade such investment due to unsubstantiated fears of “Communist” China.

Since 1999, the People’s Republic of China has undertaken a formal “Go Out” economic policy by which it is actively pursuing investments in foreign countries “…with resources or raw materials that are lacking within China, which the national economy requires for its development” (Dobson, 2014). This state-endorsed expansionist economic policy is a major reason for China’s growing share of outward FDI in Canada. According to the Conference Board of Canada, “A key priority of Chinese FDI is to develop global supply chains in order to service domestic demand for resources. Not surprisingly, there is a focus on resource-rich countries” (Grant, 2012). The same report also concluded “the forces driving high levels of FDI from China are unlikely to abate. Therefore, China will continue to increase its share of global and Canadian FDI stock” (Grant, 2012).

Due to long-term economic trends, including China’s economic emergence, and official state-policy, it is safe to say that there will be many takeover attempts or investments made in the near future by Chinese SOEs and other SOEs, in all sectors, including the oil sector. “Canada is a country in need of international capital to fully realize its comparative advantage based on abundant natural resources. China is a major potential source of capital from both private and state enterprises” (Dobson, 2014). Unfortunately, the federal government’s policy on SOEs announced immediately following the approval of the CNOOC takeover of Nexen is anything but welcoming towards that investment. “The Canadian government’s December 2012 policy statement…has raised the risks in several ways that the development of the oil sands resource will be underfunded” (Dobson, 2014). The statement in 2012 by Industry Canada reflects the former government’s political bias against SOEs and its bias in-favor of private sector companies.

According to the statement regarding SOEs by Industry Canada, “While the vast majority of global energy deposits are state-controlled, Canada's oil sands are primarily owned by innovative private sector businesses. If the oil sands are to continue to develop to the benefit of all Canadians, the role of private sector companies must be reinforced” (Government of Canada, 2012b). This statement reflects the Conservative Government’s clear bias against SOEs both foreign and domestic. This policy statement is still available online, representing official government policy, and it will be interesting to see how the new Liberal Government changes its stance on SOE investment, and particularly given Trudeau’s stated intention to “reset” the relationship with the People's Republic of China.

This statement by Industry Canada is valuable to policy-makers for a few reasons. 1) The statement acknowledges that the vast majority of global energy deposits are state-controlled. Therefore, Canada is severely limiting foreign investment by imposing guidelines on SOEs in all energy sectors and essentially preventing it in its largest non-renewable sector, the oil sector. 2) The statement clearly represents the former government's small government bias as it equates the private sector with "benefiting all Canadians", not the public sector or foreign-owned SOEs. Yet, private shareholders, often living abroad with little or no relationship to Canada, own private companies. Whereas, arguably, a publicly owned Crown corporation truly benefits all Canadians because they are owned equally by all Canadian citizens with all dividends or profits used at the discretion of the State.

The former Conservative government's statement reflects an ideological bias against SOEs that stems from its disdain of the National Energy Program (NEP) and its affiliated Canadian SOE (Petro-Canada). Amongst other things, the NEP's objectives were to take profits from Western Canada's oil sands and redistributed those profits to Eastern Canadians while keeping the cost of oil down for manufacturers, mainly in Eastern Canada. The NEP was both a political and economic disaster for the Liberal Government in the 1980s, culminating with the government's resounding defeat to the Progressive-Conservatives in the following election. In many ways, the federal Liberal Party has never recovered in Western-Canada from the NEP policy; whereas, the Conservative Party and its predecessor parties have been consistently dominant in the region.

The irony of the statement by Industry Canada, representing official government policy, is that the majority of private sector corporations in the oil sands are actually foreign-owned even though we consider them "Canadian" because their headquarters are in Canada. An analysis of shareholder information in 2012 found that 71% of oil sands production was foreign. "More than two-thirds of all oil sands production in Canada is owned by foreign entities, sending a majority of the industry's profits out of the country…" (De Souza, 2012). In fact, many "Canadian" oil companies, "…such as Suncor, Canadian Oil Sands and Husky, are predominantly owned by non-Canadians" (De Souza, 2012). For example, Husky Energy, although a Calgary-based company, is 91 per cent foreign-owned. Even prior to the takeover by Chinese SOE, Nexen was 70% foreign owned. Therefore, Canada's oil sector is largely foreign-owned already and that will likely continue regardless of foreign SOE investment. Most importantly, these facts make the declaration by Industry Canada that private ownership is the best way to ensure the industry benefits all Canadians, a farce—as these private corporations are majority foreign owned; meaning shareholder profits are largely accumulated outside of Canada. Therefore, if the objective of Canada's foreign investment review is to "benefit all Canadians", Canada has two options: 1) renationalize its non-renewable resource industries or 2) reform and modernize its foreign investment review process so that in every acquisition Canadians receive a maximum benefit.

As long as private enterprise is the preferred method of ownership, a distant shareholder's right to profit will remain the primary objective of the corporation, not the people who actually own the resource, the Canadian public. But, since Canada appears to have embraced the private-sector model, which is perhaps the best model in terms of attracting the foreign investment necessary for continued growth in a sector that requires substantial capital, Canada's policy-makers must attempt through various means, including foreign takeover reviews, to leverage the best deal possible for Canadians. To deny the investment when it is in the form of a state-entity appears counterintuitive to the objective of acquiring capital in the industry and is an approach that is rooted in ideological bias and xenophobia. Thus, Canada should not discourage SOE investment, the largest potential source of foreign capital in the energy sector in the world by far. Instead, Canada should attempt to shape this type of investment for its own strategic purposes and this begins with a modernized net-benefit analysis that enables the federal government to *maximize the benefit*s associated with foreign capital, SOE or not, for the benefit of all Canadians.

The oil sands will require substantial capital investments over the next few decades that can be more easily accumulated from foreign sources. While the price of oil has decreased substantially in the last few years, causing capital investment to decline year over year, "CAPP estimates production of Canadian oil will increase 43 per cent over 16 years, growing to 5.3 million barrels per day by 2030, up from 3.7 million barrels per day in 2014" (CAPP, 2015a). This growth will require significant capital investment in order to deliver the oil to market. "Recent forecasts from the Alberta Energy Regulator anticipate $194 billion in oil sands capital investment between 2016 and 2025" (Crowley and Speer, 2016). Meanwhile, America's relative share of total investment in Canada's oil sands is declining, requiring Canada to pursue investment from other sources. "…American investment accounts for the dominant share of Canada's FDI stock, but that has declined in relative terms from 61 per cent of the total in 2000 to 51 per cent in 2012" (Conference Board of Canada, n.d.).

And in the process of receiving investment from foreign sources, Canada is not being "taken over" by China--total Chinese investment remains rather insignificant. "Large-scale Chinese investment in Canada is a relatively recent phenomenon and, according to Canadian statistics, accounted for less than two per cent of the total inward stock in 2012" (Dobson, 2014). Yet, it was due to the fear of greater Chinese presence that Canada has severely limited SOE investment in the oil sands. The evidence does not back those fears. "The government's enhanced stringency may be a response to popular fears that China is "buying up" Canadian assets. Such fears are, for the time being at least, overblown: China's global outward FDI stocks are still lower than Canada's, and a fraction of those held by the U.S., the U.K. and Germany" (Dobson, 2014).

Even if Canada was being "bought up" by China, the federal government has the power to amend the ICA to ensure that SOEs do benefit all Canadians without closing itself off to all SOE investment, the most common form of resource ownership in the world. As the Conference Board of Canada's senior analysts put it, "The Minister of Industry has the power to create a model for investments by Chinese state-owned enterprise in Canada that would protect domestic interests without discouraging Chinese and Asian relationships that are our best hope for economic diversification in energy" (Hodgson and Bloom, 2012). Furthermore, "Many argue that it is in the national interest to seek foreign capital to develop Alberta's oil sands" (Dobson, 2014). And there is good reason to believe that going forward Chinese investment will make up an increasingly more significant portion of Inward FDI. Therefore, since Canada requires capital investment in the oil sands and since China is a willing investor with a small share of the Canadian market, why are Chinese SOEs being discriminated against by policies that effectively prevent them from investing in Canada's oil sands?

SOEs seeking to invest in Canada are treated differently than private enterprises because of fears that the SOEs are pursuing non-commercial objectives that include foreign state-interests that may, ultimately, be contrary to domestic interests. "A hypothetical example sometimes cited in this regard involves SOEs that acquire Canadian oil companies and then sell the oil to buyers in their home countries at below-competitive prices" (Globerman, 2015). The same hypothetical situation could apply to potash given that in both cases China is a primary customer of the resource and so it would be within China's strategic interest to lower the price and to do so by gaining greater market power by acquiring Canadian corporate assets, mainly reserves. Another potential risk associated with SOE investment is that they are acquiring companies in order to gain "…leverage with the host country government so that the latter is more willing to support the former in matters of international diplomacy" (Globerman, 2015). However, large, global corporations, both SOE and privately-owned, attempt to acquire assets and influence foreign governments to suit their interests and the interests of the country from which they are headquartered. The proposition that only SOEs influence foreign governments for geopolitical or diplomatic purposes is extremely naive. Lastly, if SOEs are to be feared because of their expansionist capacity and ability to leverage benefits to their domestic population, why is this a model for resource ownership that we so quickly disregard?

Western democracies have used private businesses for geopolitical purposes for hundreds of years. Publicly traded defense contractors are an obvious example, but so too are the British East India Company and Hudson's Bay Company, both privately-owned, publically-traded firms that were established by Royal Charter and functioned as an arm of the British government in colonial pursuits. More recently, TransCanada Corporation, for example, has attempted to influence the United States government in order to build the Keystone Pipeline. This undertaking was both in the commercial interests of the corporation and in the political or diplomatic interests of the Canadian government at the time. The distinction between commercial interests and geopolitical or national interests is less obvious in an increasingly globalized world. Therefore, it is hypocritical to deny Chinese SOEs the same opportunities as private enterprises when both are often seeking to advance their home country's diplomatic and strategic economic interests. Furthermore, it is always the responsibility of the host country to determine whether any "influence" is worth adhering to or not. And, legally binding conditions can be imposed on SOE investment that require these entities to perform in accordance with Canadian laws and business standards.

Importantly, the evidence indicates that Chinese SOEs are becoming more market-orientated and less state-controlled than ever before. "China's investment strategies are little different these days than those of western investors: China's government has planned to reduce its role in commercial decision-making, and seems more comfortable with allowing both nationalized and (increasingly) private businesses to pursue growth based on maximizing shareholder value, rather than enhancing national security. Moreover, modern governance practices are now gradually being introduced to the Chinese corporate world, with boards becoming more independent from the state, and improved transparency in accounting and auditing practices" (Dobson 2014). Therefore, as China undertakes market-oriented governance reforms, the best way to expedite such a process would be to work with China, to engage with them on our terms, as we own the resources they seek to acquire.

Concerns regarding Chinese SOE non-commercial objectives are overblown. According to the Fraser Institute's Report, *An Economic Assessment of the Investment Canada Act*, there is not sufficient evidence to assume that foreign SOEs are undertaking behavior contrary to free market principles. "Suffice it to say that the available evidence is not conclusive about whether or not SOEs primarily pursue non-commercial objectives. The evidence is inconclusive, in part, because of the heterogeneous nature of SOEs. In this context, a blanket policy that assumes all SOEs are non-commercial in their orientation is bound to be misguided" (Globerman, 2015). In other words, just as not all investment is equal, not at all SOEs are pursuing non-commercial objectives and should therefore be evaluated on behavior and a set of criteria that maximize the benefit to Canada instead of ideological assumptions about SOEs. This is not quite the approach the federal Conservative government took when it declared all SOE investment in Canada's oil sands would be approved on an "*exceptional basis only*" and subsequently lowered the threshold for review of SOEs relative to foreign private enterprises.

The Chinese government clearly recognizes Canadian concerns regarding the non-commercial objectives of its SOEs and has therefore attempted to publicly dissuade Canadians of them. During the CNOOC takeover of Nexen, Chinese government officials publically stated that post-takeover Nexen would operate under free-market principles. China's Minister of Commerce Chen Deming stated, "I believe these transactions will follow market rules because they are market transactions" (Wheeler, 2012).

As University of Toronto Business Professor Wendy Dobson puts it in her recent study of Chinese SOEs, "In China itself, regimes governing foreign direct investment (FDI) and state-owned enterprises are becoming increasingly transparent and market-oriented" (Dobson, 2014). Furthermore, in "…a study of the behavior of Chinese SOEs, Cornish (2012) found little evidence to support the contention that SOEs engage in non-commercial behavior intended to advance the interests of their governments. One reason is that competition forces SOEs to behave more like commercial entities” (Globerman, 2015). Therefore, it is evident that the concerns regarding SOE behavior is overblown and should not be used as a reason for preventing SOE investment in the oil sands unless there is evidence of such behavior. As the Fraser Institute’s Report on the ICA succinctly puts it, “If SOEs do not generally act non-commercially, it is unclear why they should be singled out for stricter treatment under the Act" (Globerman, 2015).

Even if Chinese SOEs were acting non-commercially, Canada has numerous policy levers by which to prevent such behavior or limit its impact. The Conference Board of Canada has argued in its numerous analysis’ of the Investment Canada Act that Canada has other means by which it could ensure Canadian interests are protected in takeovers involving SOEs. “Specifically, they must ensure that the company operates on normal commercial principles as opposed to being under politically-motivated direction from Beijing” (Hodgson and Bloom, 2012). According to the Conference Board of Canada, federal policy-makers should create a “Chinese Wall” between the supposed political objectives of China and the new Canadian-subsidiary. “This wall should be based on undertakings that would require there be a Canadian board of directors for the subsidiary, local issuance of shares, Canadian nationals in senior management, the separation of marketing from mainline operations, and senior executives being resident in Canada” (Hodgson and Bloom, 2012). In other words, Canada can and should act through policy and legislative means to protect itself from any perceived political interference from China. This will require concessions on both sides, but is better than either alternative, a) politically-controlled operations or b) no investment from the world’s largest economy in one of Canada’s largest industries.

During the Twelfth National Congress of the Communist Party of China in 1982, then Chairman Deng Xiaoping stated, “We must integrate the universal truth of Marxism with the concrete realities of China, blaze a path of our own and build a *socialism with Chinese characteristics”* (Xiaoping, 1981). In this statement, the Chairman was referring to a socialist market economy or state-capitalism--a combination of an open-market economy and a dominant state-owned sector. This has been the official economic policy of the Communist Party of China since Chairman Deng Xiaoping implemented these reforms in the 1980s after decades of disastrous economic policies undertaken by his predecessor Chairman Mao. According to Hogson and Bloom, analysts with the Conference Board of Canada, in order to protect Canadian interests while allowing foreign takeovers by Chinese SOEs, Canada should adopt a policy of

"Chinese capitalism with Canadian characteristics", a play on the former Chairman Deng Xiaoping's expression, *"socialism with Chinese characteristics"* (Hodgson and Bloom, 2012). This kind of approach would require a modernization of the Investment Canada Act in order to properly protect Canadian interests without discouraging or outright prohibiting all Chinese SOE investment. "Whatever worries Canadians may have about Chinese state-owned enterprises investing in Canada, raising investment barriers is a blunt and flawed solution. Rather than block Chinese capital, Canadian regulators should monitor the behaviour of all firms to ensure standards are met for safety, environment, labour laws, transparency and national security. Closing off Canadian companies to Chinese bidders can hurt Canada's economy. It could increase risk for, and discourage, private-equity investors who often see foreign takeovers as a possible exit strategy, while potentially sheltering poorly managed firms from takeovers, dragging down our economic efficiency" (Dobson, 2014).

It is for these reasons in addition to those already discussed in this section that Canada should reform its current discriminatory policy towards SOE investment and evaluate these takeovers and investments just as thoroughly as private capital. The risks of SOE investment are overblown and the benefits, if enforced by a modernized net-benefit test that *maximizes the benefit* for the Canadian public, include the provision of jobs, substantial royalties, and the foreign capital necessary for economic growth.

*4.6 **Conclusion***

The new guidelines for SOEs in the oil sands represent a watershed moment for Canada's policy on foreign investment. For the first time since the regulation of foreign takeovers in Canada began in the 1970s, the federal government will base the evaluation of foreign investment in the oil sector on whether a company is a SOE or not. "For the purposes of evaluating proposed investments by foreign SOEs, Section 20 of the ICA and supporting Guidelines require that the investor satisfies the Minister of the investment's commercial orientation; freedom from political influence; adherence to Canadian laws, standards and practices that promote sound corporate governance and transparency; and positive contributions to the productivity and industrial efficiency of the Canadian business" (2012b).

For the first time ever, the government will therefore evaluate a foreign takeover based on the degree of government influence, which is both hard to define and plausible in the private sector as well, but not a company's human rights record, labour practices, environmental record, ability to engage with Indigenous peoples or corporate social responsibility. If a company is truly going to be "free from political influence", this would suggest all proposed investment by SOEs will be denied, potentially leaving Canada out of significant investment that could provide a net-benefit to the country.

The largest foreign takeover in Canada's energy sector—the $15.1-billion China National Offshore Oil Company (CNOOC Ltd.) acquisition of Nexen Inc. in 2012—raised numerous and substantive policy challenges for Canada that remain unaddressed. Should the government be skeptical of, limit, or deny foreign investment from SOEs in general or just certain SOEs? SOEs represent the largest potential source of global Foreign Direct Investment (FDI) in the energy sector, as the vast majority of global energy deposits are state-controlled. Chinese FDI accounted for a mere 3.4 per cent of our total stock in 2014, meaning a) Canada could benefit from more investment from one of the world's largest economies and b) fears about China "buying up" Canada are not factually based. Furthermore, the energy sector is also in dire need of capital. The Canadian Association of Petroleum Producers (CAPP) estimates capital investment has declined 62 per cent in the oil and gas sector since 2014.

Canada already has numerous and substantial investment from SOEs, including France's Areva, in the uranium industry. This is so, despite the fact that the uranium industry, for obvious reasons, is more sensitive to national security concerns than the oil industry and yet we have effectively denied future acquisitions in the oil sector by SOEs, not the uranium sector. If the argument against SOEs is a threat to national security, would not an investment in our uranium sector by a foreign SOE be a concern? Why is the uranium sector open to SOE investment but not the oil sector? The answer is likely because the issue at stake during the CNOOC takeover of Nexen was a Chinese SOE, not a French SOE.

Should Canada declare certain resources (in this case oil) "strategic" and therefore off-limits to foreign SOE investment entirely? In a sense, that is what has occurred in the case of CNOOC/Nexen whereby the Government of Canada declared only the *oil sector* subject to stricter guidelines for SOEs and declared that future SOE investment in that resource sector would occur on an "…exceptional basis only."

Like all foreign takeovers, the CNOOC takeover of Nexen was not sufficiently transparent, as Canadians do not know all the conditions agreed to in order for the takeover to occur nor was the public privy to the reasons for the federal government approving the bid. The Harper government scrambled to adjust its policies in the wake of the takeover bid and produced a hypocritical policy in the process—allowing this takeover to occur, but ensuring that the same takeover, in the future, would not.

CNOOC's public undertakings announced during the takeover of Nexen Inc. "…were to: boost capital investment in Canada; maintain Nexen's workforce of 3,000; keep all of Nexen's senior executives; list CNOOC shares on the Toronto Stock Exchange and; make the company's Calgary headquarters the centre of its Americas business" (2017b). However, two years after the takeover, "…half of the company's senior executives at the time of the takeover are no longer with the company…" Furthermore, "CNOOC started laying off employees as soon as it took control, resulting in a climate of fear about who will be next, according to several current and former employees interviewed." Shareholders of Nexen Inc. did very well however. "As the last to get in under the wire for SOE takeovers, Nexen shareholders did well in the deal — the bid amounted to a 61% premium over Nexen's July 20 stock price" (2017b). Therefore, if the objective of Canada's foreign investment policy is to maximize shareholder profit than it succeeded in this objective. Whereas, if Canada's foreign investment policy were designed to maximize the benefit to Canadians, as it should, than it would have failed in this case.

The popularity of Premier Redford declined significantly after the approval of the CNNOC takeover bid and she resigned less than two years after the takeover occurred when her popularity was just 18% (Commisso, 2014). There were many contributing factors to her unpopularity but she supported the foreign takeover of a Canadian headquartered company and subsequently lost favour with the public. By contrast, Saskatchewan Premier Brad Wall opposed the BHP Billiton attempted takeover of PCS and his popularity sky-rocketed as a result, helping him win a super-majority in the 2011 Saskatchewan provincial election. These case studies represent two different policy approaches to foreign takeovers in Canada's non-renewable resource sector, and two very different political results for the provincial premiers involved.

CHAPTER 5:
CONCLUSION

5.1 Introduction

To reiterate, the central objective of this thesis has been to provide an overview and assessment of the policy and process related to foreign investments, and particularly either a partial or complete acquisition of companies operating in the natural resources sectors in Canada. More specifically, the purpose has been to ascertain problematic features of that policy and process, and to identify and recommend some potential reforms for eliminating or at least minimizing those problems. For that purpose, this thesis has provided an overview and analysis of two recent and precedent-setting takeover bids in the non-renewable resource sector that were reviewed by Prime Minister Stephen Harper's Conservative government, namely the BHP Billiton 'hostile' takeover bid for Potash Corporation of Saskatchewan (PCS) in 2010, and the China National Offshore Oil Company (CNOOC) 'non-hostile' takeover bid of Nexen Inc. in 2012.

In keeping with the central objective of the thesis, the objective in this concluding chapter is two fold: first, to summarize the major findings regarding what has been gleaned regarding the foreign direct investment review process pursuant to the Investment Canada Act; and second, to provide some recommendations for improving the direct investment review process. Accordingly, this concluding chapter consists of two major sections devoted to each of those two objectives.

5.2 Summary of Major Findings

To reiterate, the four central research questions of this thesis were: Why did the federal government not approve the BHP Billiton takeover bid of PCS? Why did the federal government approve the CNOOC takeover bid of Nexen? What do these two decisions by the federal government suggest are the problems in the foreign investment review policy and process? What reforms are needed to the foreign investment review to eliminate or at least reduce some of those problems?

The answers provided by this thesis to those questions are as follows. First, the federal government did not approve the BHP Billiton takeover bid of PCS because it was a 'hostile' bid strongly opposed publicly both by PCS and by the Saskatchewan provincial government. Second, it approved the CNOOC takeover bid of Nexen because it was a non-hostile bid and was not opposed strongly either publicly or privately by Nexen or any provincial government. Third, both decisions by the federal government suggest that there are some significant problems to the foreign investment review policy and process. Fourth, several reforms are required to eliminate or reduce some of the significant problems to the foreign invest review policy and process that became evident in the context of the two reviews undertaken and decisions rendered by the federal Conservative government led by Prime Minister Stephen Harper.

The takeovers studied in this thesis raised several important points regarding the following five related sets of policy issues:

Federal-provincial relations: The key issue is whether the federal government should involve and possibly even defer to the provincial government in the case of a takeover bid in the non- renewable resource sector that the provincial legislature opposes.

Strategic resource control: The key issue is whether Canada should declare certain resources strategic and therefore off-limits to foreign ownership or control.

State-owned enterprises: The key issue is whether certain resources should be off-limits to SOE investment or whether Canada should restrict SOE investment to a greater extent than publicly traded/privately-owned corporations.

Net-benefit analysis policy/criteria: The key issue is whether the existing ‘net-benefit’ analysis policy and particularly the criteria embodied in that policy enables Canada to *maximize the public benefit* of foreign acquisitions in the non-renewable resource sector.

Foreign investment review process: The key issue is whether Canada’s current foreign investment review process is sufficiently transparent and accountable to the Canadian public and foreign investors alike.

Observations regarding these five policy issues suggest that some major reforms are needed to improve Canada’s foreign investment review process. The major recommendations are discussed below.

5.3 Major Recommendations

Several major recommendations emerge from this overview and analysis of the two case studies. The most important of these recommendations are listed and explained, in turn, below.

5.3.1 ***Review Process Must Provide A Greater Role For Provinces***

First, the federal government should, by means of policy or legislation, defer to a province (or multiple provinces depending on the scenario) in its evaluation of a foreign takeover in the non- renewable resource sector, if the province (or provinces) stands to lose more than $200 million in annual royalty revenue as a result of a takeover, or 25% of the previous year's revenue from that resource. This more balanced and co-operative approach to federalism would ensure that provinces have a veto in one crucial policy matter in the evaluation of a foreign takeover that solely, directly and substantially impacts their treasury. Given provincial constitutional authority for the "…development, conservation, and management of non-renewable resources" (Government of Canada, 2017e) under Section 92A of *The Canadian Constitution Act, 1982*, but federal constitutional authority for the "Regulation of Trade and Commerce" and therefore, the evaluation of foreign acquisitions under Section 91 of *The Canadian Constitution Act, 1982*; there is inherent conflict in the separation of these powers concerning foreign acquisitions in the non-renewable resource sector. Provincial treasuries are most impacted by the acquisition of corporations in the non-renewable sector due to royalty rights that are constitutionally enshrined and yet provincial legislatures have no direct control of their sale. As it stands, a provincial Premier must make a determined lobbying effort to block or approve a takeover. This was clearly evident in the case of Saskatchewan's Premier Wall's effective lobbying efforts to convince the federal government not to approve the BHP Billiton hostile takeover bid for PCS because the province would likely lose $200 million per year in royalty revenue. Based on this fact alone, the federal government could have blocked the bid but there is no consideration of provincial royalties in the current "net-benefit" test. Of course, even if such a policy regime were put in place, the province could waive this veto if the corporation undertakes other compensatory commitments. This policy, or legislation, coupled with the mandatory disclosure of undertakings, could also have the positive affect of encouraging corporate social responsibility. It would certainly create clarity in the evaluation process where there is currently ambiguity as to the role of the provinces in Canada's foreign investment review process.

In 2010, BHP Billiton was caught off-guard by the province of Saskatchewan's successful appeal to block their takeover bid because the federal government is solely responsible for the evaluation of foreign acquisitions. Therefore, under this proposed policy of deferment, under certain circumstances, investors and businesses would be required to engage with provincial governments, rather than bypass them, overlook them, or indulge their concerns superficially. Canada's current net-benefit analysis framework *considers* the industrial, economic, and cultural objectives of the legislatures affected. This is highly ambiguous and is therefore insufficient for investors and provincial interests alike. The current policy leaves the applicant business unsure as to the exact circumstances upon which the federal government, due to provincial objection, would block a takeover. BHP Billiton's attempted takeover of PCS brought this issue to the fore and Canada's decision to block the bid has set a precedent that requires clarification.

5.3.2 Need for Dispute Resolution Mechanism

Second, the federal and provincial governments should negotiate a dispute resolution mechanism. Currently there is no framework for federal-provincial dispute resolution as it pertains to foreign takeovers, and yet there is a high risk of conflict. Therefore, in addition to a policy that would give the provincial government a veto under certain circumstances, the federal and provincial governments should negotiate a formal mechanism or framework agreement that would help ensure future conflicts are resolved without any threat to national unity as has been the case in the past in Canada when the issue at stake involves resource revenues and issues of resource management. This mechanism should be explicitly written into the Investment Canada Act and should be a function of Investment Canada. The core purpose of this dispute resolution mechanism would be the satisfaction of both levels of government and ensuring a maximum public benefit as a result of any foreign acquisition. Establishing a *quadruple foreign investment review framework* that would include: i) federal government, ii) the provincial government (s) directly affected, iii) the company being pursued, and iiii) the acquiring company, could achieve such a purpose.

5.3.3 <u>Net-Benefit Analysis Criteria Must Be Broadened & Modernized</u>

Third, the "net-benefit" analysis must be broadened and modernized so as to address the relevant issues of contemporary Canada in a globalized world. This requires an evaluation of foreign takeovers based on factors in addition to those that are economic or purely monetary focused. Currently, economic or monetary factors are the sole consideration of the "net-benefit" analysis. Additional factors should include the impact of the investment on national security, Indigenous communities, corporate social responsibility, and the environment. A triple bottom line (social, environmental, and economic) foreign investment review process would be a more comprehensive means by which to evaluate foreign acquisitions in the non-renewable resource sector. This is consistent with policy implored by comparable countries such as Australia.

Furthermore, "…it is hard to imagine that most Canadians would not wish to be assured that the federal government was examining an investor's record as a responsible environmental steward" (Assaf and McGillis, 2013). Such an approach would ensure a more accurate "net-benefit" analysis in the true sense of the term "net-benefit". For policy experts and decision-makers to solely consider economic factors in the evaluation of a foreign takeover is a disservice to the long-term viability of the entire non-renewable resource sector.

Prior to the implementation of the Investment Canada Act and its "net benefit" test in 1985, the Foreign Investment Review Act (FIRA) governed Canada's foreign investment review process. The FIRA required the acquiring corporation to pass a "significant benefit" to Canada test. However, the factors were largely identical in both the ICA and FIRA tests, in part, because both tests were designed to mitigate the risk of investment from the United States of America. In the 21st century, an era defined by the forces of global capital flowing from a growing pool of sources, Canada's foreign investment review process should be modernized so as to ensure a "maximum benefit" with additional factors to those that are purely economic. The emergence of the People's Republic of China as a growing source of foreign capital investment necessitates such an approach—that is, if Canada is to remain competitive in attracting its fair share of global FDI without sacrificing its democratic values and interests.

This *"maximum benefit" test* would evaluate foreign takeovers using a triple-bottom-line analysis (economic, social, environmental) to ensure that Canadians derive the maximum benefit from foreign takeovers in the non-renewable resource sector, a sector of diminishing assets. This, in addition to the mandatory disclosure of undertakings, more power for the federal government to enforce corporate undertakings, a mandatory national security review, a policy or mechanismto encourage a more collaborative federalism, the consideration of a province's royalty revenue which is often at stake in these transactions, the equal treatment of SOE and private enterprise investments, the treatment of all non-renewable resources as strategic, and a requirement that federal decisions must be disclosed to the public, will ensure Canadian public interests are paramount in foreign acquisitions going forward. The objective of this "maximum benefit" test is not to dissuade foreign investment, a necessary and desirable form of investment; rather it is designed, based on precedent, to clarify Canada's foreign investment review process where there is currently ambiguity; diversify Canada's FDI sources; and ensure Canadians receive the *maximum benefit*, or greatest return on investment, for what is theirs.

5.3.4 Review Process & Decisions Must Be Clearer & More Transparent

Fourth, the process used to evaluate foreign takeovers must become more transparent both in the decisions made and in the undertakings of the acquiring corporation. The current 'net benefit' analysis process on which a foreign takeover is currently evaluated is ambiguous and the means by which these evaluations are reported to Canadians is non-transparent. It is essential that Canadians are fully and properly informed on these matters. If they are not, the decisions of federal and provincial governments will likely encounter significant legitimacy problems, and the governments will encounter significant political problems. It is also essential that there is clarity in the process for foreign investors. Under the current system there is insufficient transparency regarding both the rationale for the government's decision and the commitments made by the acquiring company.

To correct these deficiencies the federal government should publish a more detailed explanation for any review decision, stating which of the factors contained in the net-benefit analysis were used and why, but also the undertakings (commitments made by the acquiring company) when a foreign acquisition occurs. As stated by the Competition Policy Review Panel (2008), this mandatory disclosure of undertakings can be achieved without sacrificing "commercial confidences" and the current policy does not meet modern standards of accountability and transparency.

5.3.5 Do Not Differentiate Between Private & State Owned Companies

Fifth, contrary to current federal policy implemented after the approval of the CNOOC Ltd. takeover of Nexen Inc. in 2012, investments or takeovers proposed by State Owned Enterprises (SOEs) should be evaluated equally as rigorously as privately-owned/publicly-traded enterprises. This means that the federal government should change its current and discriminatory approach towards SOEs that only allows SOE investment in the oil sector on an "exceptional basis only." In addition to being unnecessary, this policy is not sufficiently clear and therefore creates confusion that discourages investment and fosters distrust with one of Canada's major trading partners and one of the world's largest economies, the People's Republic of China. SOEs control the vast majority of resource reserves in the world and are therefore a form of investment Canada cannot afford to dissuade without a fair analysis. Concerns regarding China "buying up" Canadian industry is not based in fact, as China accounts for less than 4% of Canada's inward FDI stock. Concerns regarding the non-commercial activity of SOEs are overblown and can be addressed by a stringent national security review contained within a more ambitious maximum benefit test (triple bottom line analysis) that should be equally applied to any foreign investment or takeover, regardless of whether the entity is state-owned. There is strong evidence that demonstrates Chinese firms are increasingly operating by commercial principles in a market- driven global economy. To artificially shelter Canadian firms from this form of investment could negatively impact economic efficiency and growth in a key sector of the Canadian economy.

5.3.6 All Non-Renewable Natural Resources Should Be Protected Equally

Sixth, and related to the previous recommendation, all resources should be equally protected by a modernized, transparent, and comprehensive foreign investment review. Canada's foreign investment review process should evaluate the acquisition of all non-renewable natural resources by any foreign investor equally thoroughly. As a result of the blocked BHP Billiton takeover attempt of PCS, the federal government should clarify that all non-renewable resources will be afforded the same kind of scrutiny under the Investment Canada Act's net-benefit analysis, regardless of the resource being acquired. And, similarly, as a result of the successful CNOOC Ltd. takeover of Nexen Inc. the current Liberal government of Prime

Minister Trudeau should declare that all forms of foreign direct investment will be required to meet the same standard of review, SOE or not. To be clear, this does not infer that all resources are the same or that all investments are the same. On the contrary, such a policy recognizes that all investment is uniqueand each takeover circumstance unique, and therefore a policy is required that will not discriminate against any investment prior to a fair and thorough analysis based on clear and consistent criteria.

Regardless of what company is involved in a transaction concerning a "Canadian business", former Alberta Premier Alison Redford wisely argued that, "Whether an investor is coming from another part of Canada, or another part of the world … they are simply buying leases to extract our resources on our terms" (Crydermn, 2012). A similar sentiment was expressed, albeit implicitly or indirectly, by Premier Wall when he was asked about the province's leverage in foreign acquisitions of its resource companies. "We're not pawns, we're the sheriff and nobody mines or extracts anything here unless the people say it's OK" (Francis, 2010). He further added, "I would say this, and have repeated this, not only to send a message to people here and to the rest of the country: Potash belongs to the people of the province. It doesn't belong to Potash Corporation or any other entity" (Francis, 2010).

It is therefore the specific factors, defined in the ICA's net-benefit analysis, with which policy-makers should be most concerned, not the nationality of the majority of shareholders or the nationality of the acquiring entity, or whether the resource company being acquired extracts a "strategic resource". Issues of corporate or shareholder nationality become far less relevant if Canadian policy-makers reform the ICA in order to maximize Canadian interests because the resources belong to Canada, corporations are only leasing them on our terms, which we must define. "Unlike other factors in production, such as capital goods (e.g., machinery and equipment), natural resources are country-specific. This gives bargaining clout to states endowed with them, allowing these states to accept foreign investment only on the best terms possible, particularly in times of booming commodity prices" (Library of Parliament, 2011). Canada therefore, has significant leverage in foreign acquisitions, and must use it by reforming and modernizing its current foreign investment review process to maximize the benefit to all Canadians.

5.4 Areas of Further Research

There are several areas of further research that could provide substantive value to policymakers. Not discussed in this thesis are the components of a thorough national security review of foreign takeovers in the non-renewable resource sector. A national security review is of value and should be an integral part of a maximum benefit test. However, a national security review is not a unique consideration of policy-makers assessing acquisitions in the natural resource sector and therefore priority was given to other issues that are. As Canada expands its pool of FDI sources to include nation-states that Canadians are not as familiar with, national security reviews of these investments will become more crucial and therefore research in this area will be increasingly valuable. Under what circumstances should the federal government block a takeover because of national security concerns in the non-renewable resource sector? This question warrants further research and analysis. The issue of political interference and influence was addressed in some detail in this thesis in the section on SOE investment, but is political interference in the management of a non-renewable resource company a threat to national security?

The issue of strategic resource ownership and control during the BHP Billiton attempted takeover of PCS, brought to the fore the issue of market power or market share of a particular resource, in this case Potash. Is there a market share threshold beyond which Canada should limit the foreign ownership of a resource company? I.e. should a foreign corporation be allowed to acquire say 50% of Canada's reserves of any particular resource? What, if any, are the risks of such an acquisition? This issue was discussed under the section on "strategic resources" in Chapter Three, but warrants further research from a purely economic perspective.

As discussed in the section on SOE investment and in the introduction, the vast majority of resource reserves are owned by SOEs. Why is this the case? Are these corporations successful on a global scale? Why are Canadians so averse to the SOE/Crown model of resource management if a large majority of the world has adhered to such an approach? Using Chinese SOEs as case studies, what are the public advantages and disadvantages of the SOE/Crown model in today's economy? These firms and their operations are difficult to study because research and knowledge is limited in Canada.

A related issue is that of investment reciprocity in the non-renewable sector. From an economic perspective, this issue warrants further research. China offers limited investment reciprocity in its non-renewable sector. Is this a relevant concern for Canada? Should Canada withhold investment from China until there is reciprocal investment allowed by China? What is the best policy or approach to encourage China to allow reciprocal investment in the non-renewable resource sector? These questions require further study and analysis.

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